

## RIIO-ED2 Cost Assessment Working Group (CAWG) – 28<sup>th</sup> April 2020

From: Ofgem

Date: 28<sup>th</sup> April

Time: 10am to 1pm

Location:  
Teleconference

### 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)  
Centrica

### 1. Review of DNO responses to ED2 Uncertainty Mechanisms

- 1.1. Ofgem reviewed DNO feedback on uncertainty mechanisms (UMs). The focus was on whether Ofgem should retain, reform or remove existing ED1 UMs.
- 1.2. WPD asked how the work carried out by the OAWG would feed through the CAWG, since UMs are discussed there as well. Ofgem replied that the cost assessment team were attending as many other working group meetings as possible to ensure alignment, and asked DNOs to keep aligned in their respective companies too.
- 1.3. WPD signaled the need for clarity of direction on load related expenditure (LRE) UMs. Different options are on the table, and it would be best to have a clear decision in the Sector Specific Methodology, prior to business plan submission. WPD advised against relying on bespoke submissions for LRE.
- 1.4. On the licence use, exit charge and business rates UM, DNOs had a clear consensus that Ofgem should retain the mechanism.
- 1.5. Ofgem noted a broad DNO consensus to retain the high value project UM, although some DNOs recommended slightly updating its materiality threshold. UKPN clarified that their comments only advocated minor changes. WPD asked how the UM interacted with competition thresholds also being discussed.
- 1.6. WPD highlighted that the feedback on the critical site security UM did not point to much further work. WPD had suggested removing the mechanism for its low materiality, but clarified that its position could change. SSE suggested replacing this UM with an Ofgem reopener.
- 1.7. On the street works UM, Ofgem advanced that DNOs broadly agreed to reform the mechanism. WPD mentioned that uncertainty remained for some DNOs on street

works, and asked whether costs associated with clean air zones would be subject to a specific UM.

- 1.8. For UKPN, a volume driver approach could be more appropriate for street work costs, as it would require less 'introspection' during the price control. However, if the mechanism were different from the GD2 approach, stakeholders would need to be comfortable with the difference in approach. NPG stressed that an UM has to concentrate on what is outside DNOs' control. For example, the number of lane rental permits applied for by DNOs was not a good index because it is under DNOs' control – 'permits granted' would be more appropriate.
- 1.9. Ofgem pointed that DNOs were split between retaining and reforming the rail electrification UM. ENWL replied that the net zero agenda was prompting a review of the rail electrification timeline, which overlaps with ED2 significantly. The rail electrification strategy would be published in 2021.
- 1.10. UKPN questioned whether an ex-ante mechanism would be appropriate for smart meter interventions, given that BEIS is moving the rollout deadlines to 2024, the covid-19 pandemic is negatively affecting interventions, and DNOs are already behind on targets. UKPN argued that business plans were submitted two years before the start of the price control, so uncertainty would remain then. NPG pointed out that by business plan submission stage, there could be enough clarity for an ex-ante allowance to be granted. NPG, WPD and NPG agreed that an UM could be needed here, but that it would need to be as mechanistic as possible.
- 1.11. Ofgem stated that DNO had a consensus to retain the UM on DCC fixed costs. WPD and SSE had suggested retaining the smart meter IT UM; this UM is linked to the discussions on smart meter interventions.
- 1.12. Ofgem and DNOs discussed cyber costs UM. NPG expressed its preference for an ex-ante mechanism, arguing that the current mechanism was creating distortive cost boundaries. WPD replied that cyber costs could be covered with an ex-ante allowance, but that any uncertainty could fall under a reopener. UKPN asked for SP and SSEN's views from ET2.
- 1.13. **Action: SSEN to circulate information to the WG on the treatment of cyber costs in ET2.**
- 1.14. On cross-sector coordination, NPG and UKPN warned against perverse incentives created by the coordinated adjustment mechanism (CAM). WPD signaled that 'cross-sector' licence conditions were being drafted in the GD and transmission Licence drafting WG, and asked whether they would apply to ED as well. UKPN signaled that it was involved in the Licence Drafting WG, and that the cross-sector licences applied to ED too.
- 1.15. **Action: Ofgem to provide clarity on cross-sector license conditions for RII02.**
- 1.16. Ofgem highlighted that most DNOs seemed to align on asset replacement NOMs, apart from SSEN. SSEN clarified its position, stating that more justifications on the methodology and criteria would still be required.

- 1.17. On whole system costs, Ofgem also noted the consensus for reform among DNOs. WPD stressed the cumbersome nature of the existing UM. On the tax liability UM, UKPN questioned whether this was attainable by all DNOs. Ofgem flagged that the Regulatory Finance team at Ofgem would soon set up the Finance WG for ED2, where tax liability would be discussed.
- 1.18. WPD and UKPN asked if Ofgem if other information would be needed to make a decision on UMs. NPG noted that decisions on mechanisms and their designs would be needed for Ofgem to develop BPDTs.
- 1.19. **Action: Ofgem to circulate the NPG's UM feedback template again once SP feedback is received.**

## 2. Bespoke Uncertainty Mechanisms

- 2.1. Ofgem presented slides on bespoke UMs, covering what had been outlined in the RII02 Business Plan Guidance document and lessons learnt from other sectors so far. Ofgem suggested using a template for bespoke UM submission. ENWL mentioned that this would help DNOs to structure submissions, especially if it includes the assessment criteria.
- 2.2. Ofgem and DNOs discussed the need for bespoke UMs in ED2. WPD pointed out that the work undertaken by the WG sought a more common approach to UMs. ENWL agreed with using a common approach to UMs, to gain clarity on UMs ahead of business plans submission instead of using submissions to 'reveal' new mechanism ideas.
- 2.3. NPG stated that as ED2 would be shorter than ED1, it should require less UMs. The electricity distribution sector has more scope for comparative benchmarking than transmission, which affects the need for UMs. Bespoke UMs would also make DNO's submissions disparate, hindering the benchmarking exercise. NPG added that comparisons with ED1 were more relevant than with ET2 to build ED2.
- 2.4. WPD urged Ofgem to review and remove bullet number 5 in paragraph 5.18 of the Business Plan Guidance document. WPD argued that the BPDT and BP process actively encouraged DNOs to submit many UMs.
- 2.5. UKPN asked whether the Challenge Group had issued any feedback on bespoke UMs. There is a risk that the group will expect BP submissions to include bespoke UMs, following the approach taken by the other sectors.

## 3. Ofgem presentation on lessons learnt from other sectors on the use of Engineering Justification Papers (EJPs) and key principles for ED2

- 3.1. Ofgem provided an overview and presented what had been published so far on EJPs, lessons learnt from other sectors and a walkthrough of an ED1 assessment. Ofgem noted that there was a range of volumes and structures submitted in the EJPs and limited data had been submitted in other sectors. Ofgem pointed out that there is a need for a strong narrative and a transparent explanation of the calculations for data submitted. This will therefore decrease the number of Supplementary Questions (SQs).

- 3.2. ENWL suggested whether DNOs should take an action to think about how EJPs will be used in the ED2 submission. Ofgem agreed and pointed out that DNOs could work together and outline a standardised approach for ED2 to Ofgem.
- 3.3. NPG stated that there are six different DNOs (ownership groups), which could result in several different sets of EJPs. NPG continued and said this could increase administrative costs, as Ofgem will need to review the papers. NPG questioned how this would interact with the cost benchmarking where a large amount of the cost base is covered by totex regressions and noted that if the Ofwat approach were taken, this would cover a wide area in the cost base and limit the need for EJPs.
- 3.4. Ofgem suggested that a number of data points are already available for DNOs. Ofgem further noted that if the EJP format is standardised – there could be a streamlined assessment compared to other RIIO sectors. The EJP guidance will be common for everyone; this will make sure that the costs are efficient. NPG stated that disaggregated assessments in ED1 cost consumers £1bn. This is because more information is being monitored and the higher the asymmetry of information between DNO and Ofgem – this could increase the cost for consumers.
- 3.5. WPD pointed out that where EJPs are required, further guidance would be useful. Across ED, there are over thirty cost and volume tables. Therefore, it would be useful to know whether EJPs will be required and what potential exceptions there are. Ofgem noted that in other sectors there has been a sensible aggregation of costs. EJPs should provide transparency into the decision making process. WPD stated that EJPs should only be used where they add value and stressed the need to avoid duplication.
- 3.6. UKPN implied that sending hundreds of papers hinders transparency and excessive information does not help. Therefore, a right balance of information is needed to achieve transparency. For example, high volumes of information will affect appetite and ability for stakeholders to review submission. Ofgem stated that there is a limit to the amount of information and that documents should not have an excessive amount of pages.
- 3.7. UKPN suggested that the next steps could be that DNOs work together to take a view on the levels of cost aggregations for the EJPs. WPD suggested that it would be helpful to have a view from Ofgem on the type of information that we need in EJPs.
- 3.8. **Action: DNOs to provide view on levels of cost aggregation for the EJPs.**

## 4. Cost Benefit Analysis (CBA)

- 4.1. Ofgem presented slides on CBAs and outlined what was set out in the ED2 Framework Decision. DNOs queried whether there were any thoughts on how CBAs and EJPs worked, and feedback from the other sectors. Ofgem noted that there were difficulties where licensees made assumptions before the CBA and advised that without going through a set of options in the CBA, the results became questionable.
- 4.2. WPD presented on CBA model interdependencies. ENWL advised that their workshop had identified a number of interdependencies, which were either existing or evolving.

4.3. ENWL view that this need to be handled in a coordinated way to avoid multiple versions of CBA models. Noted requirement for a common core model and have add-ins bespoke to each purpose there. Example given of a core framework and innovation benefits etc. so that a standard model can be developed for all these areas. ENWL advised that we would need to avoid a CBA model competition. Ofgem agreed that a core model is key and that the ENA ONP is looking at this. Ofgem underlined that consistency across approaches is key and that oversight of where CBA model is used will be factored in.

4.4. UKPN question to Ofgem on what we were thinking on VoLL and whether we would rely on DNOs research for regional VoLL? Ofgem advised that work was being done on this and that this would be consulted on. Ofgem noted this has implications across the price control for CBAs but also for CNAIM. Advised this would come out in the summer consultation.

4.5. **Action: Ofgem to set out working group sub group to focus on CBAs for ED2.**

## 5. Scenarios and Forecasting

5.1. Ofgem stated that it would be useful to have an early sight of DNO ED2 forecasts by the end of August / September. There was a discussion on the practicalities and usefulness of the DNOs providing these forecasts at this stage.

5.2. **Action: Ofgem will write to the DNO Regulation Managers, setting out more detail on why we want these forecasts, before any request for information is made**

5.3. There was a discussion around scenarios. WPD stressed the need for a common forecasting scenario across DNOs for cost assessment, and asked if there would be different BPDt submissions in the event that multiple scenarios are put forward for ED2. Ofgem will feed back information from the other sectors on the lessons learnt in this area.

5.4. **Action: UKPN to share slides from the OAWG subgroup on scenarios**

## 6. Future WG work plan and SSMC

6.1. The agenda for the next CAWG on 26 May was discussed. The aim is to include a high-level review of some of the elements of the summer consultation, but this will depend on where the other sectors get to with Draft Determinations.

6.2. WPD asked if there could be another item on EJPs.

6.3. Ofgem invited DNOs to present views on 26 May on what future timelines could look like.