

RIO-ED2

Cost Assessment Working Group – Meeting 8



Electricity Distribution Team
14th May 2020

- Welcome and Introductions: 10:00-10:15
- Ofgem presentation on early ED2 forecasts: 10:15-11:15
- SSEN presentation on early ED2 forecasts: 11:15-11:45
- Incremental costs: 11:45-12:00
- Actions, Next Steps, AOB: 12:00-12:30

Ofgem presentation on proposals for early ED2 forecasts

Purpose of Forecast

- Provide early sight of potential size and scope of RIIO-ED1:
 - Using information currently available (current charging arrangements etc)
 - Not tying hands for RIIO-ED2 Business Plans
- Identify areas where there could be major changes compared to RIIO-ED1. Working groups discussions have named a few (PCBs, LRE...)
- Early view of how companies have devised their plans and the issues they foresee at this stage in a supporting commentary
- Understanding the assumptions built in to forecasts & the rationale for doing so
- Provide data for early runs of benchmarking models

Period forecast covers

- DNOs currently forecast to the end of ED1 in M16
- The forecast to be submitted in Sept 2020 covers the remainder of ED1 and the full ED2 period (8yrs)
- Why are Ofgem requesting the forecasts
 - To gauge where companies will exit RIIIO-ED1
 - To gain early visibility of ED2
 - Part-period forecast “unrealistic” and “unhelpful”

Level of detail

- C1 (cost matrix) level of detail
 - Simplify C1 or use M16 table and un-grey cells as intended
- Balance between getting visibility of key areas without going into too much detail at this stage
 - In working groups DNOs have raised that incremental costs will need to be identified (climate change adaptation, PCBs, *touch an asset once*)
- Cost forecast requested only
 - Without volumes can have limited value?
 - To understand incremental costs are volumes required?
 - Units distributed
 - Incremental asset replacement volumes
- Seeking to avoid unnecessary re-cutting of currently reported information
- No implications on the annual reporting packs

LRE to date in ED1

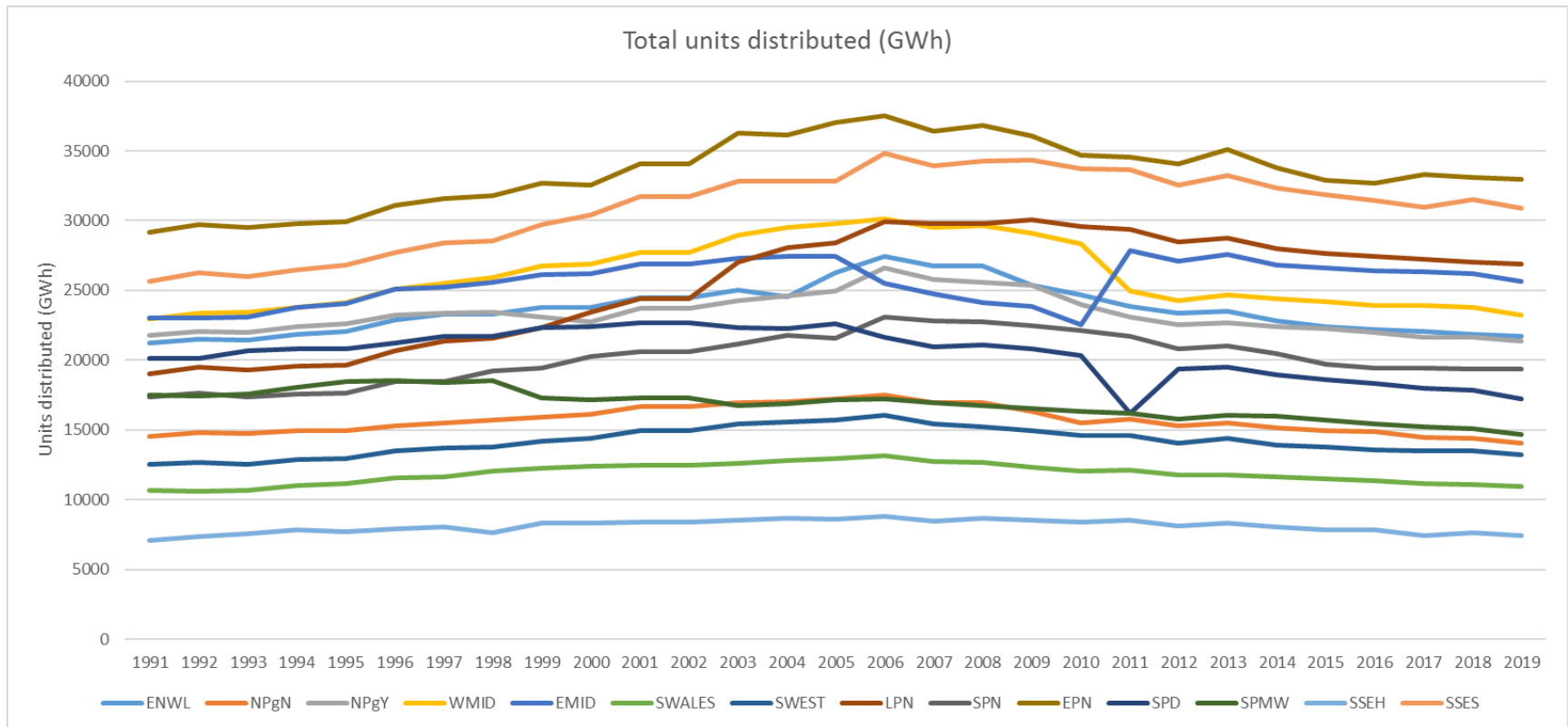
	Spend	Allowance	Over/underspend	
ENWL	£ 22	£ 62	-£ 40	-64%
NPGN	£ 44	£ 62	-£ 18	-29%
NPGY	£ 38	£ 44	-£ 6	-14%
WMID	£ 75	£ 100	-£ 25	-25%
EMID	£134	£ 148	-£ 14	-9%
SWALES	£ 17	£ 23	-£ 6	-25%
SWEST	£ 42	£ 34	£ 8	22%
LPN	£ 81	£ 176	-£ 95	-54%
SPN	£ 44	£ 121	-£ 77	-63%
EPN	£ 68	£ 176	-£ 108	-62%
SPD	£ 60	£ 84	-£ 23	-28%
SPMW	£ 77	£ 87	-£ 10	-12%
SSEH	£ 25	£ 49	-£ 24	-50%
SSES	£ 62	£ 115	-£ 53	-46%
GB	£788	£ 1,280	-£ 492	-38%

- All DNOs are forecasting to underspend over the course of the price control (apart from SPEN who are forecasting to spend in line with allowances)
- **How will LRE enter ED2?**

- For Load as a whole, no company is currently overspending.

LRE ED1 Forecast

	Spend	Allowance	Over/underspend	
ENWL	£ 103	£ 135	-£ 32	-23%
NPGN	£ 85	£ 107	-£ 22	-21%
NPGY	£ 89	£ 105	-£ 15	-15%
WMID	£ 170	£ 223	-£ 53	-24%
EMID	£ 285	£ 297	-£ 12	-4%
SWALES	£ 53	£ 55	-£ 2	-4%
SWEST	£ 95	£ 96	-£ 1	-1%
LPN	£ 275	£ 352	-£ 77	-22%
SPN	£ 146	£ 216	-£ 70	-33%
EPN	£ 230	£ 361	-£ 130	-36%
SPD	£ 141	£ 141	£ -	0%
SPMW	£ 166	£ 166	£ -	0%
SSEH	£ 101	£ 131	-£ 31	-23%
SSES	£ 179	£ 233	-£ 55	-23%
GB	£2,118	£ 2,618	-£ 500	-19%



- The level of Units Distributed on the DNOs networks was at its highest in 2006. Units distributed have reduced by **15%** since then.
- Will DNOs use their existing spare capacity to facilitate LCT connection without reinforcing their networks?
- **What is the likely impact in ED2?**

SSEN presentation on proposals for early and informal ED2 forecasts

Ofgem Proposals for an Early and Informal ED2 Forecast

May 2020



- Ofgem's proposals appear to be similar to the "Strategic Thinking" exercise conducted for T2
- Based on SSEN's experience of T2, we feel the "Strategic Thinking" exercise carried out early on within the RIIO-T2 process offered little benefit to Ofgem, other stakeholders or the company. It also required significant effort which it could be argued would have been better focused and added greater value elsewhere
- **We are keen to explore the extent to which this exercise been carried out in other sectors? Was it worthwhile? What did Ofgem or other stakeholders use this for? What benefit and value did it deliver? How did it inform policy? How did it compare to draft BP submissions?**

Initial Difficulties

- ❑ What scenario(s) should the DNO use?
- ❑ How do we ensure clarity and consistency in approach in the absence of a common methodology or guidance
- ❑ What assumptions should be made on ED2 uncertainty mechanisms? How should these be quantified? Templates not set up to allow capture of data
- ❑ What targets and network performance metrics does the DNO work to? (e.g. CI/CML)
- ❑ Annual Reporting submission deadline extended to 31st August given additional COVID19 pressure – this is a significant additional piece of work which will add to pressure, particularly given short notice
- ❑ DNOs will also be working on SSM consultation responses and Draft Determination Consultation for T2 and GD2, over and above annual submissions already

Key Risks

- × **No** Stakeholder Engagement to inform plan (volumes and costs) at this early stage
- × **No** CEG involvement
- × **No** assessment of willingness to pay
- × **No** inclusion of innovative or market based solutions
- × **No** data assurance/governance on submission
- × **No ability to refine** cost estimates
- × **Incorrect** assessment of high/low confidence buckets for BPI assessment
- × Use of ED1 run rates and targets not reflective of ED2 environment
- × Poor interpretation of high value uncertainty areas
- × **Any initial "benchmarking" is likely to carry a high risk of being misleading or invalid**



September 2020

M16 – Forecast Table
Rolled forward view of ED2 costs in current RRP format

Range
Initial Max and Min range of Totex accounting for very early interpretation of UMs

**Investment Driver
Uncertainty estimate applied**
List of drivers where costs have increased substantially based on inclusion of new ED2 activities

December 2020/January 2021

Same as September 2020 position

Volume Requests
For some regulatory drivers – tables must be agreed in advance and will be subject to further refinement

Refined Totex Range
Based on initial stakeholder and CEG engagement on agreed areas

Data Templates
Would require BPD to be made available well in advance of a more detailed submission

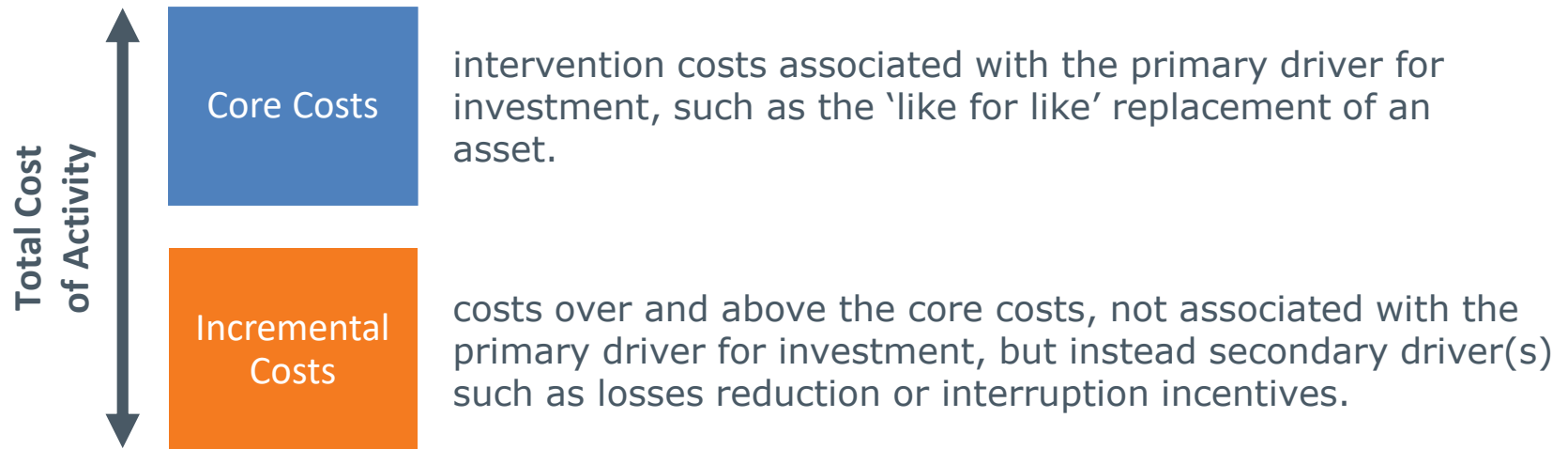
Key Risks on previous slide still exist but may be partially mitigated



- Ofgem's Sector Methodology decision document should set out policy decisions and a framework that delivers under all scenarios
- The framework should provide sufficient flexibility to cope with changes in priorities, scale and timing of works, services and investment given uncertainty associated with net zero, and now arguably the economy!
- **SSEN believes Ofgem do not need this forecast to complete sector methodology decision**
- If more information is required in earlier timescales than originally agreed, we need to significantly descope e.g. focusing on forecast by cost category rather than BPDT.

Incremental Costs

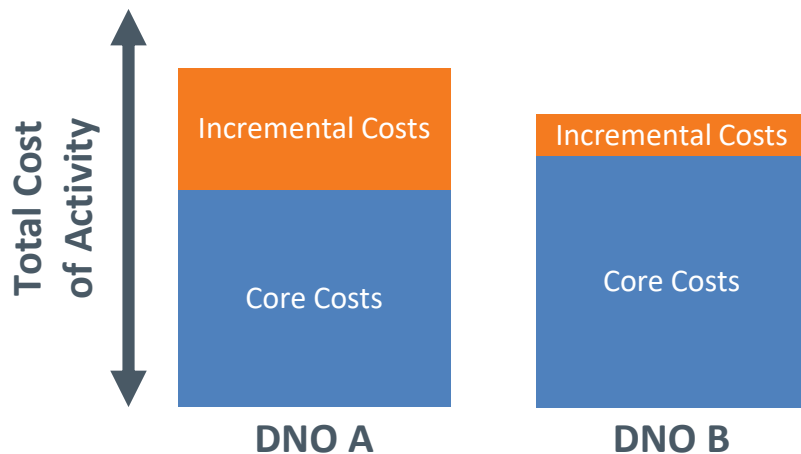
- 'Incremental Costs' and the treatment of these costs in RIIO-ED2 has been flagged several times throughout Cost Assessment and Safety, Resilience and Reliability (SRR) Working Groups.
- In the context of ED, what do we mean by incremental costs?



- In RIIO-ED1, the only place where incremental costs are explicitly identified is in the Environment and Innovation tables.
 - In tab E4 – Losses Snapshot, licensees enter the estimated incremental component of the unit cost that is justified by Distribution Losses benefits.

- Discussions through the SRRWG have centred around areas such as climate change adaptation and flooding. In the OAWG there have been discussions around upsizing network capacity and the 'touch once' principal to asset interventions.
- Given these challenges, it may be that in ED2 there is greater scope for opportunistic intervention, and that there won't be many asset interventions that can be categorised as having only one driver for investment.
- The RIGs, as currently set up and excluding the Environment and Losses pack, are not structured to deal with this.

The challenge for Cost Assessment:



- In this example, both DNOs report the total cost of activity. This includes the core costs and the incremental costs, informed and justified by CBA.
- If only the total cost of activity is reported, and cost assessment approach is based on this, DNO B looks more efficient than DNO A.

- **What is the scale or the materiality of this issue in ED2, and in what specific areas (demand and capacity, losses, then elements of resilience coming in?**
- **What options do we have for treating these costs in ED2?**
 1. Split core and incremental costs out within the RIGs tables.
 2. Adjust for these costs in our cost modelling, like a regional or company specific factor. For example:
 - DNO A say activity costs £20k, which is made up of 80% core costs, and 20% incremental costs.
 - DNO B say activity costs £18k, which is made up of 90% core costs and 10% incremental costs.
 - Benchmark them on the core costs. DNO A is most efficient.
 3. If all DNOs are carrying out similar activities around climate change adaptation, upsizing of assets etc. do we need to consider core and incremental costs separately.

- Actions, Next Steps, AOB
- The next meeting will take place on 26th May.
- We will circulate notes and an actions log from this meeting.