

Overarching Working Group – Meeting 11



Consumer Value Proposition

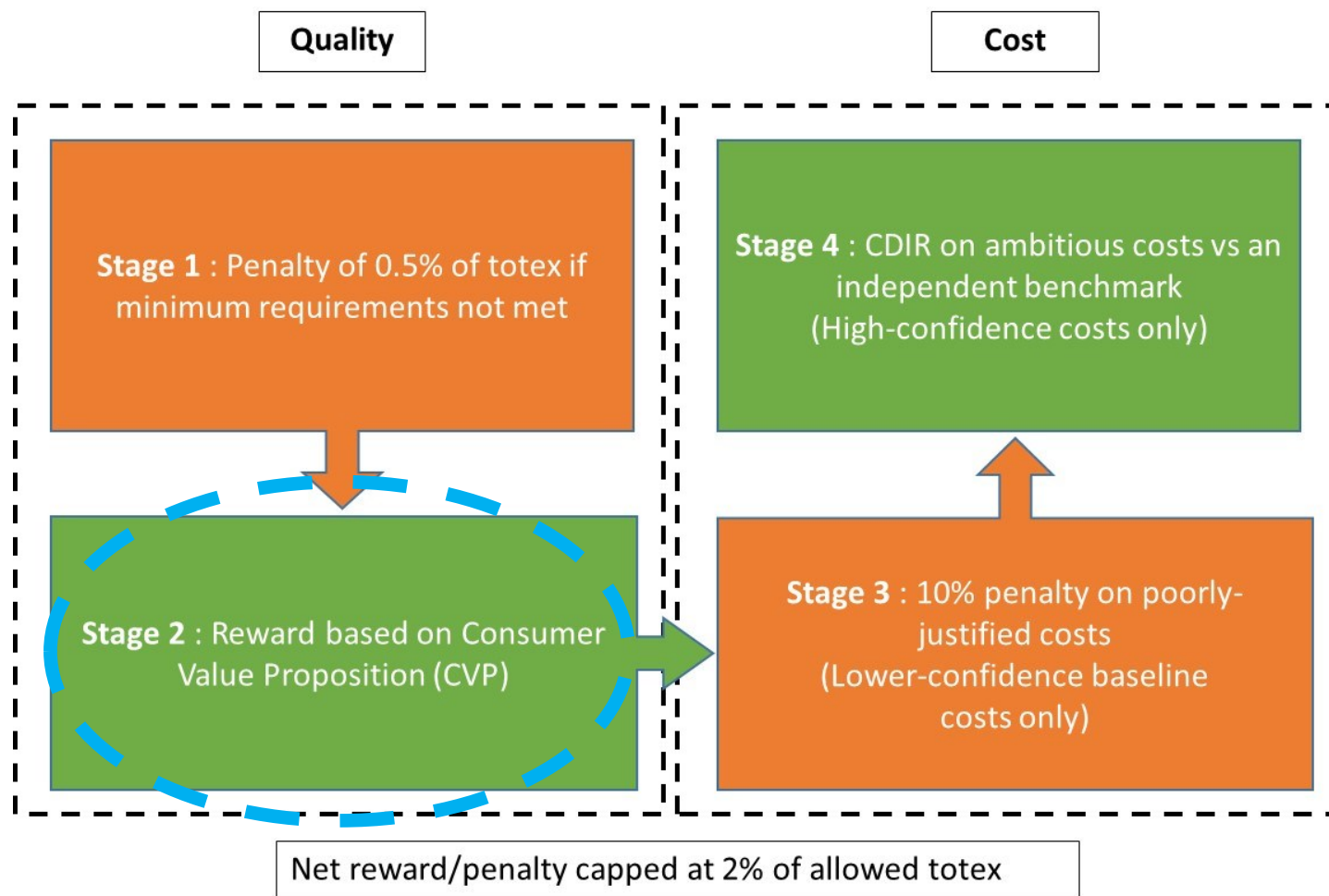


2/10/2020

Today's focus areas:

- Our proposals to align the areas in which companies develop CVP proposals with specific priority areas for RIIO-ED2
- Using DNO business plans to set standards in those areas
- Capping the number and value of CVP proposals

The overarching aim of the BPI is to encourage companies to prepare high-quality and ambitious Business Plans.



“We would carry out an assessment of what additional value the Business Plan offers to consumers, beyond the minimum requirements the plan offers and beyond the functions typically undertaken by an energy network company as business as usual. Our proposal is that in their CVPs, a company should demonstrate the additional value its plan will generate for consumers. **The reward will be reflective of this additional value.**”

“We believe that the CVP can be a powerful tool for driving and demonstrating ambition in companies’ Business Plans and that by aligning the areas in which companies develop CVP proposals with specific priority areas for RIIO-ED2, the service offered to consumers in these areas of activity can be enhanced.”

In the sector methodology consultation, we proposed that CVP proposals should fall into one of the following categories:

- Proposals that demonstrate approaches to **DSO activities** that clearly go beyond the baseline standards
- Proposals that demonstrate approaches to **providing services to vulnerable consumers** that clearly go beyond the baseline standards
- Proposals that demonstrate approaches to **providing services to large connection customers** that clearly go beyond the baseline standards
- Proposals that exceed the baseline standards that we have set out for **Environmental Action Plans**
- Proposals that exceed the minimum requirements that we have set out for **whole system approaches**

Questions:

- What are your views on inviting proposals in only these areas?
- Are there other areas that you think should be added to the list (or areas you think should be removed?)

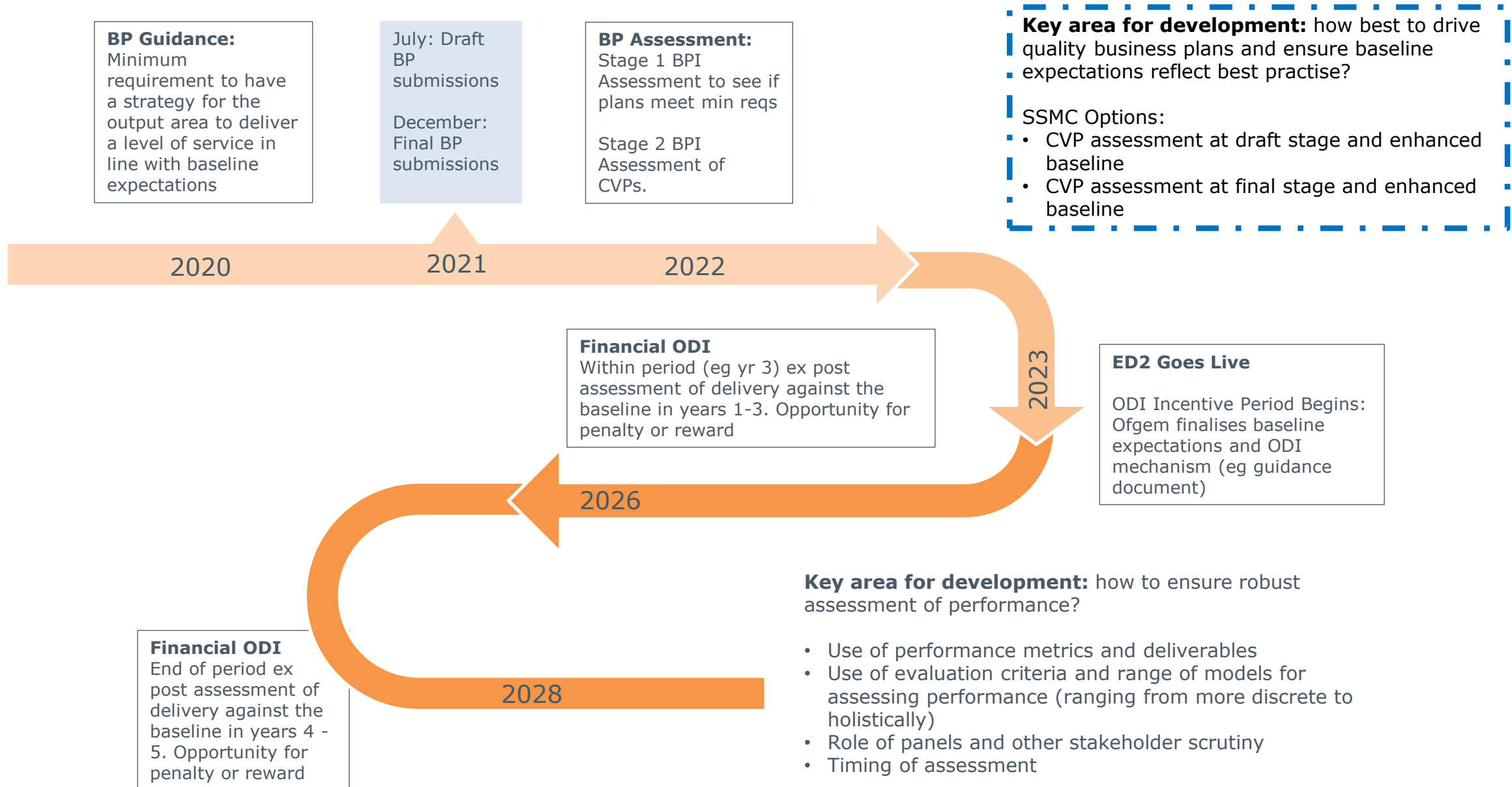
In each of the following areas, we have proposed to put in place an output delivery incentive through which we would undertake an **ex post evaluation of companies' performance** against those strategies

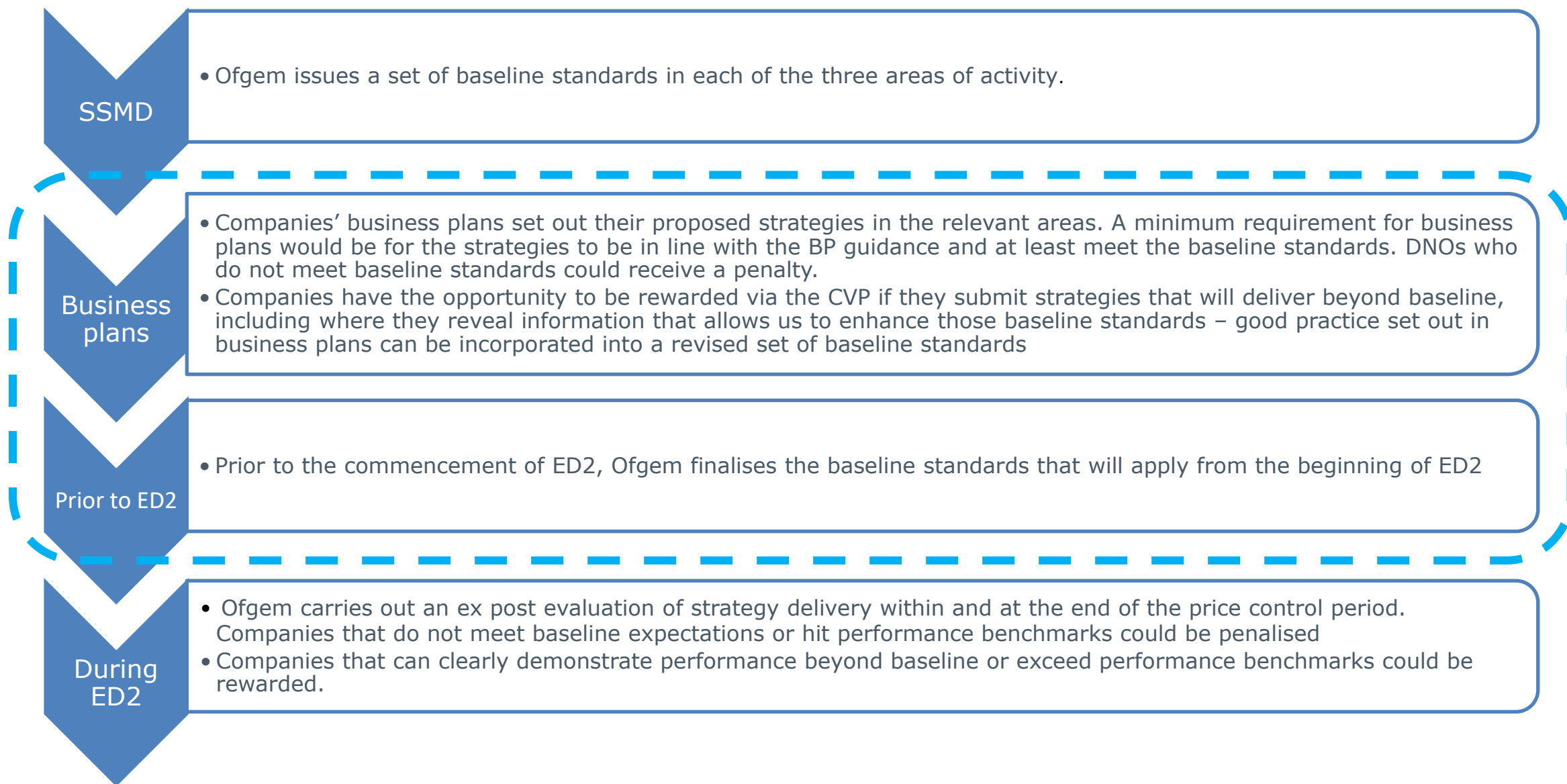
- DSO activities
- providing services to vulnerable consumers
- providing services to large connection customers

...and have proposed that the CVP could be used in helping to set enhanced baseline standards in these areas for use within RIIO-ED2

Why might this kind of approach be appropriate in these areas in particular?

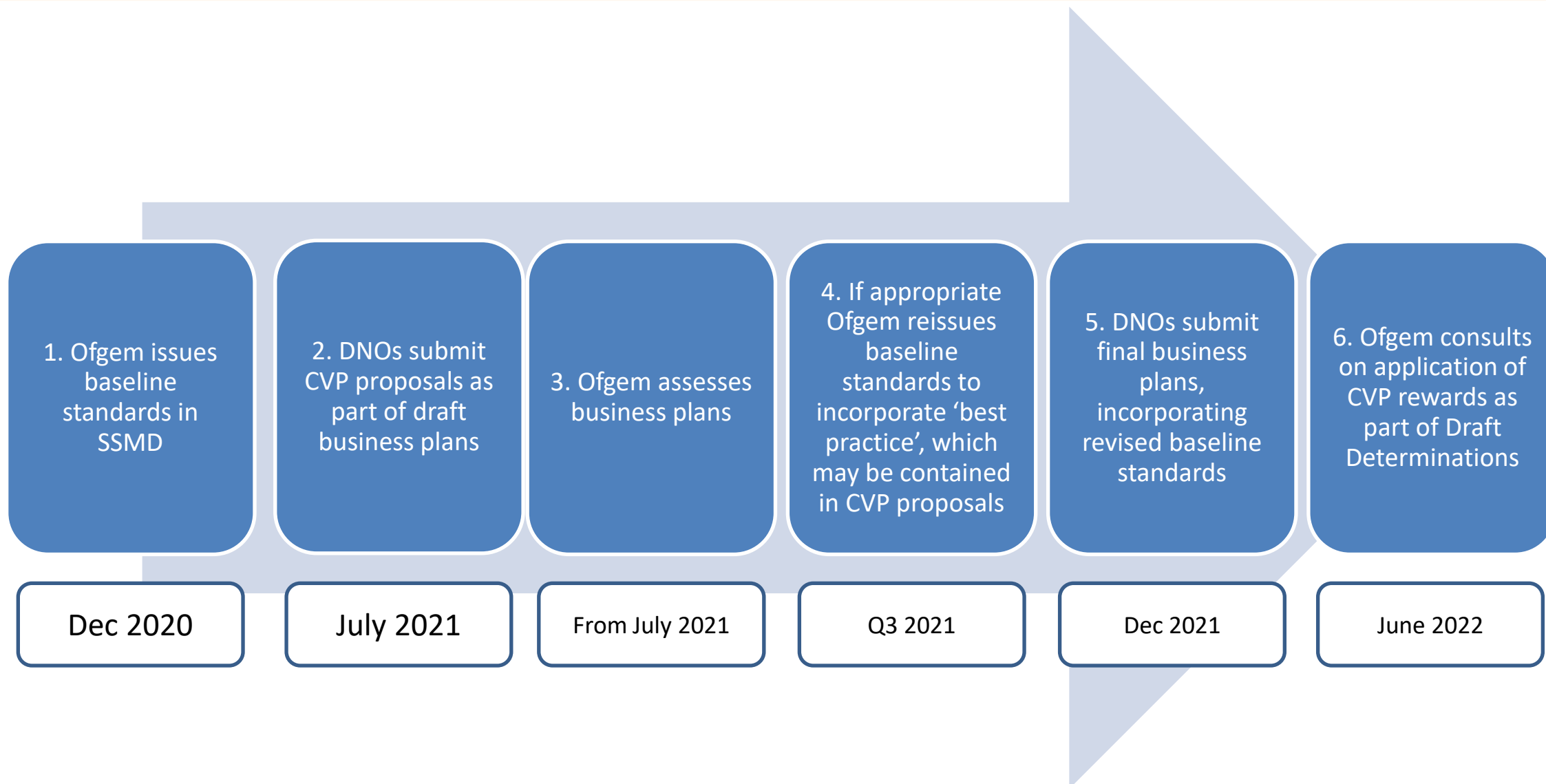
- We think these areas are the ones where we may get the most useful information from DNOs plans in setting the standards that will apply in RIIO-ED2
- In some instances, they may relate to newer areas of activity where we may be less able to determine specific outputs or activities.

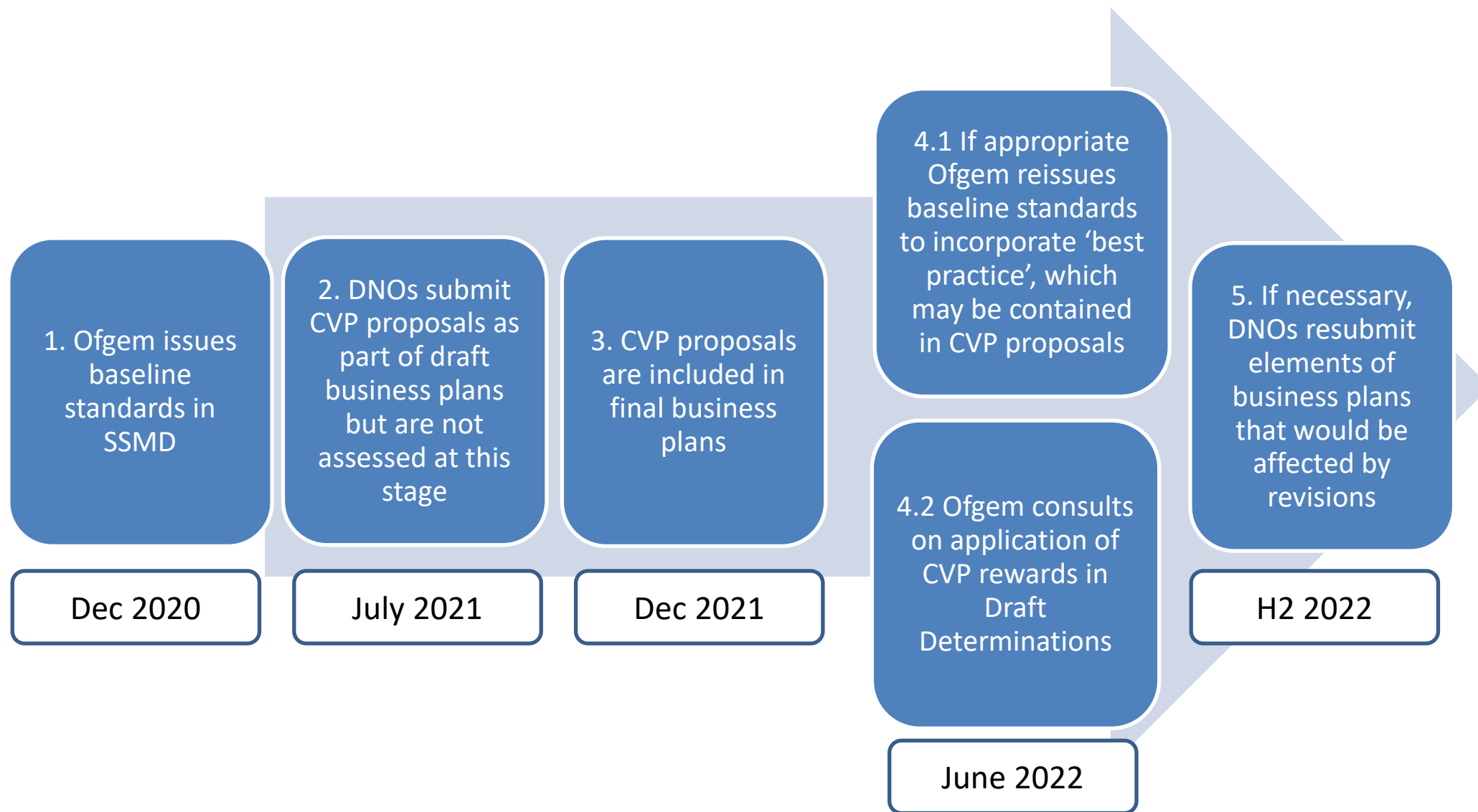




- DNOs will submit draft business plans in July 2021
- In the SSMC, we said that there may be value in using draft or final plans in the establishment of the set of baseline standards that will apply in RIIO-ED2
- Where appropriate, CVP proposals could be incorporated into an enhanced set of baseline standards that could apply to the whole sector
- In the next slide we consider how this could work

Option 1 - Ofgem reissues baseline standards prior to submission of final business plans





- Under Option 1, using the content of draft plans in setting ED2 baseline standards means that any revised standards could be reflected in final business plan submissions, including cost forecasts
- This would, however, require to Ofgem to review DNOs' draft plans, reissue guidance and DNOs to respond in the period July – December 2021
- Under Option 2, if baseline standards were revised and this requires updates to be made to business plans, companies would need to submit these updates to Ofgem following Draft Determinations

Questions:

- What are your views on Options 1 and 2?
- Under Option 1, if Ofgem reissues baseline standards prior to submission of final business plans, should companies be held to the BPI minimum requirement in respect of any revised baseline standards?

- In the SSMC, we proposed to set upper and lower limits on the value of CVP proposals as well as a limit on the number of proposals that are brought forward.
- The rationale for this is that a lower limit would ensure that proposals are sufficiently material and an upper limit would ensure that DNOs' focus remains clearly on the core, common areas of activity.
- We indicatively suggested a lower limit of £3m per proposal and an upper limit of £10m. We proposed that the aggregate value of proposals should not exceed £50m and that the total number of proposals would not exceed ten per business plan
- To give a sense of scale, at the ED sector level and after application of a 50% totex incentive mechanism rate, £300m (6 DNOs x £50m) represents circa 0.5% of allowed totex in RIIO-ED1 (~£28bn)

Questions:

- What are your views on the proposal to limit the number and value of CVP proposals?
- What are your views on the proposed limits?

Ofgem is the Office of Gas and Electricity Markets. We are a non-ministerial government department and an independent National Regulatory Authority, recognised by EU Directives. Our role is to protect consumers now and in the future by working to deliver a greener, fairer energy system.

We do this by:

- **working with Government, industry and consumer groups to deliver a net zero economy at the lowest cost to consumers.**
- **stamping out sharp and bad practice, ensuring fair treatment for all consumers, especially the vulnerable.**
- **enabling competition and innovation, which drives down prices and results in new products and services for consumers.**

Application of the Business Plan Incentive (BPI) and Baseline Standards proposals

Caroline Ainslie
2nd October 2020

Introduction

The SSMC proposes adoption of the same Business Plan Incentive (BPI) as was applied in other sectors

- Based on perceived outcomes from the DDs we believe there is a need for greater clarity and detail on how Ofgem intends to apply each stage of the BPI in RIIO-ED2.
- This should ensure that DNO business plans deliver maximum consumer value and minimises wasted input and resources by DNOs, their stakeholders and Ofgem.
- Ultimately Ofgem's ED2 BP guidance should be clear and comprehensive setting out all possible BPI outcomes by the SSMD in Dec 2020 - there should be no surprises at ED2 Draft Determinations.

The SSMC proposes that Ofgem use DNO Business Plan proposals (from their DSO, vulnerability and major connections strategies) to apply new baseline standards across DNOs

- We believe there is a need for greater clarity on how this would work in practice and whether all potential unintended consequences have been considered.



BPI Stage 2 - CVPs

In the other sectors circa. 95% of CVP proposals were rejected by Ofgem at DD

- There is a clear need for greater transparency and clarity regarding Ofgem expectations and process for assessing CVPs.
- Limits on value and numbers of CVPs may provide some focus BUT will not resolve the underlying confusion.

Of the small number of CVPs accepted, Ofgem disputed the benefits valuation methodology

- A common Social Return on investment (SRoI) tool is being developed in the CSCVWG – would be helpful for Ofgem to confirm view on using this for CVP proposals or what the alternative should be



BPI Stages 3 & 4

Without clarity in this area then DNOs could spend resource producing supporting evidence that Ofgem does not value AND Ofgem could miss key information amongst huge volumes of supporting documentation received

Application of the Confidence Dependent Incentive Rate (CDIR) method is key to the setting of the TIM and also the application of BPI stages 3 & 4;

- **Clarity on 'known' high confidence categories:** Ofgem statements in GD2 DD that costs that can be benchmarked (Ofgem econometric models) are regarded as high confidence. Ofgem should be able to state in the SSMD what cost categories would automatically fall into high confidence.
- **Movement from low to high confidence:** For potential low confidence categories Ofgem should be clear on what evidence would be regarded as sufficient justification to support a move from low to high confidence.
- **Treatment of innovative and new areas:** Ofgem should set out clearly how innovative practices and processes including those relating to the DSO, will be treated and not unduly penalised given the lack of established comparators.
- **Justification of lower confidence costs:** Low confidence costs will receive a penalty unless 'thoroughly justified'. Ofgem should set out clear criterion and expectation on extent and format of justification required
- **Stage 4 reward eligibility and assessment process:**
 - Guidance states if company has passed BPI stage 1, then it is eligible for a reward based on the proportion of high confidence costs lower than the benchmark that would have otherwise been set.
 - This implies that frontier companies passing stage 1) will be eligible for stage 4. We would have expected a similar outcome in GD2 however all GDNs were ruled ineligible, due to 'volume/workload adjustments' prior to Ofgem's econometric analysis. This was not previously understood; clarity is needed on reward eligibility and assessment process for ED2.
 - SSMC says stage 4 reward is dependent on companies providing cost information which 'must be useful'; what does this mean?



The proposal to use DNO draft and possible final Business Plans to revise Baseline Standards for all DNOs raises several questions and concerns

- **How does this enable each DNO's final business plan to reflect feedback on ambitions and priorities of its own unique set of stakeholders?**
- **How can this work in practice?**
 - Ofgem feedback to DNOs on proposed revised baseline after July 21 draft submissions: When will this take place? Period of consultation on revised baseline? Do we engage with our stakeholders? How to reflect increased costs in final December 21 submissions?
 - Ofgem feedback to DNOs on proposed revised baseline after Dec 21 final submissions: Will this be at DD? All questions as per above
 - Could baseline move between draft plan submission and final plan submission, and then again post DD?
- **How does this link with the CVP submission process?**
 - Expectation that CVP proposals submitted for every suggestion of improved baseline? Issues with max number of CVPs and minimum values
 - If DNOs propose increase baseline but do not submit a CVP – if revised baseline accepted, will Ofgem award a CVP?
 - If multiple DNOs submit CVP proposal in same area – will all be awarded?

