

RIIO-ED2 Cost Assessment Working Group – Meeting 14

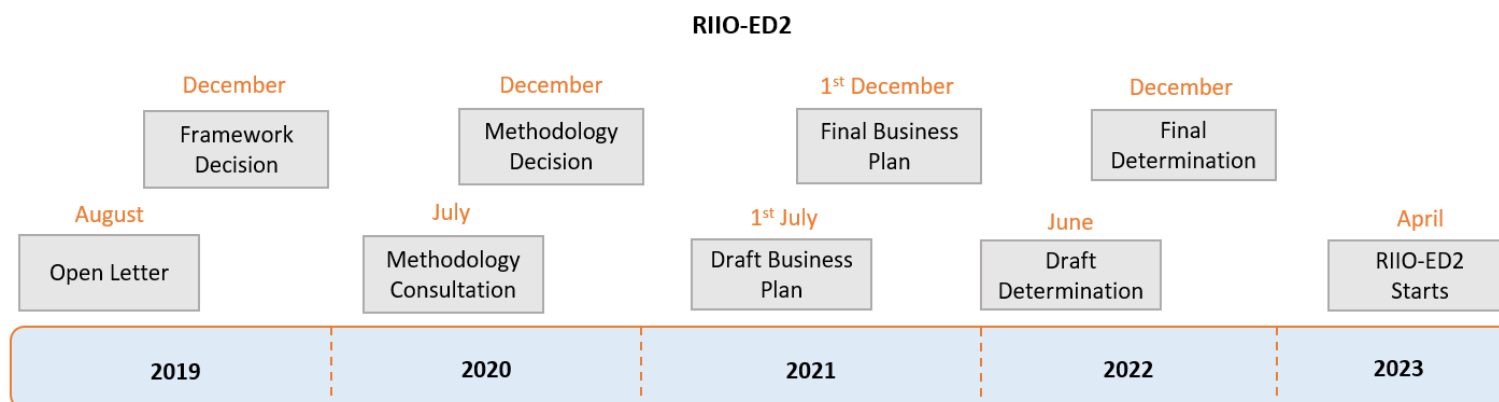


Electricity Distribution Team
19th November 2020

- Welcome and Introductions
- Real Price Effects & Ongoing Efficiency
- Regional and Company Specific Factors
- Disaggregated Modelling
- Business Plan Incentive (BPI)
- Role of Engineering Justification Papers (EJPs), CBAs
- Actions, Next Steps, and AOBs

SSMD on programme to be published in December, with exception of Regulatory Finance decisions

We are delaying all key finance decisions to February 2021. We do not expect this to affect the DNOs' ability to prepare robust drafts of their Business Plans by 1 July



Real Price Effects & Ongoing Efficiency

Overall methodology

- Ofgem use a triangulated approach and rely on a range of evidence, to not give too much weight to a particular methodology.
- Moving from RPI to CPIH is already an implied OE challenge, of 1%. We can assume that OE and RPEs cancel out to simplify ED2, and let the RPI/ CPIH move set the OE challenge.

ED historical efficiency to inform OE

- **In favour.** ED1 underspend is evidence for historical productivity gains. Moving to a smart systems brings a range of efficiency opportunities, identified by DNOs in ED1. These might lead to further savings in ED2, and should be captured.
- **Against.** No guarantee that past performance is a good indicator of future performance. ED1 had strong efficiency incentives, but this won't be the case in ED2. Using historical performance data creates perverse incentives for DNOs.

Past innovation funding to inform OE

- Previous innovation funding was not focused on efficiency gains.
- Toughening OE challenge based on past innovation disincentivise future innovation., as it limits the potential rewards.
- There is no established quantitative relationship between innovation funding and productivity.
- KLEMS data already includes innovation efficiencies from competitive sectors. Having an innovation challenge potentially double counts this
- The cost assessment process already takes into account efficiency improvements in technologies / processes incentivised by the price control.

Growth accounting methodology

Data

- The 2008 financial crisis is a structural break in productivity trends. Using data prior to this date would induce an upward bias in our productivity estimates.
- Covid-19 will impact productivity in ED2, and so we should focus on the most recent productivity estimates
- KLEMS data should be used, as it is well established. Ofgem needs to assess other datasets too though.

Comparator sectors

- Ofgem could use efficiency gains of the competitive segments of the energy sector
- A narrow selection of comparator sectors will be more relevant to understand the efficiency gains that networks can actually achieve.
- Adding more weight to the ‘Electricity, gas, steam and air conditioning supply’ sector in the KLEMS data would help capture historical efficiencies of DNOs
- As the RIIO framework seeks to mimic competition in natural monopolies, we need to consider the extent of competition in the comparator sectors that we choose, to match the level of competition that we want to mimic in ED2.
- Comparator sector’s input mixes are not a good selection criteria, since different input mixes can be used for the same output

Productivity metrics

- Labour productivity metrics should only be applied to labour related costs
- Using a TFP metric removes any distortions linked with capital substitution effects.
- Gross Output should be given more weight.
 - Not using a GO is an unjustified departure from regulatory precedent
 - Using GO is internally consistent with the costs that an ongoing efficiency assumption is applied to.
 - In ED, intermediate inputs (contractors, materials etc.) are factors of production, and so DNOs can change the input mix if their prices change. So as a result, GO is more appropriate for ED than VA.

Indexation

- **In favour.** There is a risk of inaccurate forecasting if an ex-ante allowance is granted for RPEs .
- **Against.** Indexing RPEs on other sectors will increase the risk falling on DNOs compared to fix allowances. Year to year RPE variations do not accurately reflect the actual cost variations of DNOs, which vary on a longer term basis.

Materiality

- Uncertainty should have an equal treatment in ED2, so we should match the materiality threshold for RPEs and UMs.
- A materiality threshold can't be set unless we've defined the disaggregation of cost categories, same goes for the volatility assessment. We should set this first.
- A high materiality threshold leaves smaller cost categories exposed to input price rises. This will mean that RPEs will inaccurately reflect input price variations.
- CEPA GD2 test is flawed. If we break down cost categories in small chunks, nothing passes a materiality threshold. If the entire cost base has a moderate RPE, the RPE will fail CEPA's volatility test, but still represent a high variability in costs.

Indices

- Impact of covid should be considered when picking RPE indices, to really reflect cost pressures on DNOs
- We should take into account any opportunities for DNOs to influence indices, such as those that fall under management control, when picking RPE indices.
- Ofgem should compare a wide range of indices to inform its choice, not just the ones used in ED1.
- We need to consider the interactions between regional factors and RPE indices.

Notional cost structure

- Expenditure and input categories should match the RRP – this would be impractical for the BPDTs otherwise
- Direct/ contract labour split is better than generalist/ specialist, as it is consistent with the RRP.
- DNOs' choice of resourcing (make or buy) should be subject to the same RPE adjustment, as it is covering the same cost whether contracted out or done by the DNO itself. So this suggests that no labour split is better (a single labour category).
- Input price categories are appropriate, but might need to be updated depending on the work made on DSO costs
- Some input categories are not tightly defined / nor currently reported categories in the RRP (eg Equipment/ plant)

Regional and Company Specific Factors

Areas outlined in CAWG-12:

| Area | Tasks |
|---|---|
| Criteria - Evolve current criteria outlined in SSMC | <ul style="list-style-type: none"> Determine quantitative materiality threshold (e.g. is the claim material in nature?) |
| | <ul style="list-style-type: none"> If required, specify what is deemed by a unique claim |
| Offsetting/Symmetry | <ul style="list-style-type: none"> Views to whether adjustments should fully offset each other |
| Submission form/template | <ul style="list-style-type: none"> Views on what further clarity and information is required for the Business Plan Guidance |
| Interaction between Regional Factors and Business Plan Incentive | <ul style="list-style-type: none"> Views on applicability of Regional Factors within the Business Plan Incentive (e.g. Should poorly written submissions be treated as low confidence costs and be subject to a penalty) |

Criteria (materiality and 'unique claim'):

- Materiality threshold should be used as a guide. Recommend giving the companies the discretion to bundle related regional factor claims for assessment against any materiality.
- A high bar should be applied to whether any adjustment is made and to the scale of that adjustment. Materiality should be relative to the size of the company rather than a predetermined value. Ofgem will need to consider a number of factors when developing a view on materiality.
- Unique claim should reflect uncontrollable circumstances leading to quantifiable differences. Shouldn't be relevant whether claim is unique, DNO could be requesting different levels of allowance and therefore individual claim should still be unique.

Offsetting/Symmetry

- Adjustments should not be symmetrical. Ofgem should maintain to make asymmetric regional adjustments. Correctly calibrated, one respondent agreed that a symmetrical approach would be applicable, more so to regional factors than company-specific factors.
- Agreement with the labour adjustment methodology used in RIIO-ED1 to normalise adjustments for comparative benchmarking. Symmetrical adjustments will have the same issue of imperfection as cost assessment and econometric benchmarking has.

Submission form/Template

- Further clarification would be helpful in a number of areas within the cost assessment process including Ofgem's assessment criteria and a submission form/template.
- A summary tab should be included in the BPDT capturing all company specific factors. Number of respondents suggested that Ofgem should consider how they would like the information to be received (e.g. units).
- Ofgem and DNOs should work together to clearly articulate the evidence needed for a unique claim. Companies should be required to consider any associated countervailing factors that might reduce their costs.

Interaction between Regional Factors and Business Plan Incentive

- Regional factors are high confidence costs but should be excluded from the BPI as they are beyond the DNOs control. Claims that are poorly evidenced or justified should be categorised as low confidence costs. Another respondent suggested that a low confidence penalty should be applied if Ofgem identifies that a lower regional adjustment should be made than the one proposed by the company (e.g. poor data or analysis).
- May be appropriate to apply a BPI reward/penalty if a range is outlined (e.g. DNO receives 45% of its regional factor and fails to justify 55% of its claim, then it would be a suitable approach).
- Costs should not be classified as low confidence costs if they are not supported by externally benchmarked evidence and therefore not be subject to BPI penalties in relation to regional factor submissions.

Disaggregated Modelling

- Set out the approach in RIIO-ED1, where our disaggregated modelling incorporated a mixture of cost assessment techniques appropriate to the activity in question, including regression analysis, ratio analysis, trend analysis and technical assessment

SSMC Questions

- **Do you believe it is appropriate to use bottom-up, activity-level, disaggregated modelling in RIIO-ED2?**
- **If we use a combination of aggregated and disaggregated modelling approaches, how should we determine the weight we apply to each, in combining our analysis?**
- **If we did not use disaggregated modelling approaches, what approach should we consider for disaggregating totex allowances for the setting of PCDs?**

- In our view the use of a holistic middle-up modelling should provide an aggregated view of network options. While some costs are largely fixed and can be disaggregated with an exact and replicable figure across networks other costs from ED1 are likely to vary more by network.
 - Disaggregated modelling provides an important level of detail for accurately determining totex. However, by increasingly giving greater weight to a Middle-up approach it will incentivise strategic considerations in the allocation and decision on variable costs. This will incentivise networks to consider the impact of interventions holistically to explain and justify decision making through aggregate narratives about delivery which better explain and justify decision making. Ofgem's overview of network proposals should benchmark these proposals against a view of totex value realisation from expenditure for the identified expenditure groupings.
-
- Given a new approach is likely to be required for top-down/middle-up totex, providing a weighting to disaggregated costs seems like a sensible precaution. Particularly as disaggregated costs are likely to be required for assessing price control deliverables in ED2 as in RIIO-GD2.

- We agree the use of bottom-up models is complementary to the totex approach, particularly in areas where a separate output applies (e.g. NARM), or where the DNO is proposing novel, stakeholder-supported investment.
- We suggest that Ofgem considers the combination of totex and disaggregated (disagg) modelling in two ways:
 - Assessing the same areas of the cost base and triangulating the results (as per RIIO-ED1); and
 - A hybrid approach where the cost base is split into areas covered by totex and disaggregated models and the results are added. This would allow flexibility for areas of output difference between DNOs to be fairly assessed using a disaggregated approach with reference to supporting Cost Benefit Analysis (CBA) and Engineering Justification Papers (EJP).
- We propose the use of disaggregated modelling for setting PCDs to ensure clear linkages between the deliverable and the allowed costs to deliver them without relying on inferencing or extrapolating the results of an overarching totex assessment approach.

- The use of disaggregated benchmarking should be limited to providing a cross check - and the overly complex, badly-specified ED1 models should not be the starting point.
 - Ofgem's ED1 disaggregated models cost energy consumers £1 billion pounds. They should be consigned to history, not used as the basis for Ofgem's consultation on ED2 disaggregated modelling.
- A high weight should be placed on totex, equal to or higher than the 50% weight placed on totex models at ED1, and recognising that GD2's draft determinations show that a 100% weight is possible.
 - If Ofgem introduces mid-level models it should not "squeeze" the weight on totex modelling, which is an important component of the overall scheme of totex regulation.
 - A 100% weight in totex is well supported by precedent, which proves there are no practical obstacles to it, including:
 - Ofgem's proposed GD2 approach, which relies on totex assessment for the large majority of the cost base; and
 - Ofwat's PR19 approach, which benchmarked each individual part of the water sector value chain, such as water distribution, with essentially totex regression models.
 - And to the extent Ofgem wants comfort that the proposed allowances are achievable by the companies in question, it can always maintain some form of disaggregated analysis, limiting its role to that of a cross check.

- Agree with considering a wide range of cost assessment approaches, including totex, middle-up and disaggregated modelling. By drawing on a range of evidence, Ofgem can address the fact that all cost assessment approaches may have limitations.
 - However, we do have concerns that disaggregated modelling for some cost categories may not be robust. Ofgem expressed similar concerns regarding disaggregated modelling in the RIIO-GD2 Draft Determination. Ofgem dismissed the use of disaggregated models in its Draft Determination because it has found that “some of the bottom-up models’ fit wasn’t satisfactory” and because it had concerns “over the statistical robustness of some of the models”.
 - If Ofgem decides to use disaggregated modelling for the RIIO-ED2 cost assessment, we would recommend it considers carefully whether its RIIO-ED1 cost groups and disaggregated drivers are appropriate, and likely to capture DNOs’ expenditure requirements as they ramp-up investments to help achieve Net Zero through the electrification of heat and transport.
-
- To set PCDs using disaggregated totex allowances, we believe that Ofgem could use a similar approach to that used in its RIIO-GD2 Draft Determination, also discussed in Annex 2 of the consultation document.^{19F22} For RIIO-GD2, Ofgem distinguishes between regressed costs, non-regressed costs and technically assessed costs.

- Whilst we recognise the benefits in using disaggregated, granular data to encourage cost reductions and aid transparency, we believe there are risks in using bottom-up, activity-level, disaggregated modelling. These include the micro-management of specific activities at the expense of others, setting an unachievable 'package' of cost allowances that cannot accommodate trade-offs, and complex modelling that cannot react to late adjustments in the setting of the price control. Disaggregated modelling must therefore be used carefully and only where it is appropriate.
- In terms of weighting, based on experience from RIIO-ED1, where ultimately the aggregated model was found to be more robust, we believe Ofgem should place a higher weighting, i.e. more than 50%, on its aggregated modelling. However, the ultimate weighting should be informed by the confidence underpinning each model. If learning is embedded from RIIO-ED1 and the level of disaggregation is practical and the model is clear and transparent, it may be appropriate to adopt a more balanced approach.
- Believe there is a role for disaggregated modelling approaches, providing the level of disaggregation is appropriate, practical and clear and there is sufficient confidence in the model and its outputs. We therefore believe disaggregated modelling should be used to align the allowance with activity and, in turn, set PCDs.

- Our view is that disaggregated modelling is an integral part of the Cost Assessment framework. In statistical analysis, a greater level of disaggregation improves the specification of the model and allows for a greater level of insight and value to be gained. Disaggregated modelling can take account of a greater number of factors to explain costs, which could be disregarded from TOTEX modelling for failing statistical tests of significance. The use of disaggregated models provides a narrative explaining to companies why they may be deemed inefficient. This is important when disseminating the outcomes of Ofgem's cost assessment to key stakeholders.
 - In addition, the combination of disaggregated modelling and the EJPs gives Ofgem a strong basis to draw conclusions on the efficiency of DNOs' proposals. This is not afforded by the aggregated modelling approach (which is limited to capturing differences in scale).
-
- Disaggregated modelling is a critical tool for the evaluation of business plans for the purposes of the Business Plan Incentive (BPI), and eventual TOTEX Incentive Rate (TIM). An Ofgem assessment of inefficient disaggregated costs can result in those costs being categorised as Low Confidence for the purposes of calculating a DNO's BPI and/or TIM. The disaggregated models developed at ED1 require further development for ED2. We believe that this should be an area of focus at future Cost Assessment Working Groups to refine these models.

- Due to the difficulties in identifying a suitable weight, our view is that one of the following options would overcome this difficulty and provide improved clarity and statistical merit to the cost assessment framework:
 - Define each company's modelled costs as the maximum of modelled costs across a variety of different approaches including TOTEX, Disaggregated, and Middle-Up models. This would recognise that every model is imperfect in design and would avoid unfairly adjusting companies' allowances. To avoid this modelling approach resulting in a higher TOTEX than might otherwise be the case (by using a different model), the assessment should be done before applying the upper quartile adjustment.
 - Use an aggregation of 100% disaggregated modelling; however, this does not consider the full suite of cost assessment which is Ofgem's favoured "Toolbox" approach.
 - Use a combination of different benchmarking methods, selected on a case-by-case basis. This would remove selected elements from the statistical benchmarking. A similar approach was also taken in the recent Draft Determinations for T2. For ED2, this could involve a middle-up model approach, aggregated with specific activity level analysis for areas unsuitable for regression, or explanation by scale alone.

- Ofgem has acknowledged that the treatment of ODIs and PCDs, specifically Network Asset Secondary Deliverables (NASD) requires development for ED2 cost assessment modelling. In ED1 there were inconsistencies with the secondary deliverables contract. The discrepancies between the disaggregated and TOTEX cost modelling made it challenging to ensure that output targets were consistent with allowances set. Ofgem's approach in ED1 was to scale back the volumes prescribed by the disaggregated benchmarking to align with the benchmarked TOTEX allowances. The result was that some DNOs were set targets that differed from Ofgem's own disaggregated modelling results. We believe disaggregated methods are the best means for setting output targets in relation to PCDs and once these targets are set there should not be any further adjustments.
- An overall toolbox approach to cost assessment is appropriate. Bottom-up, activity-level, disaggregated total expenditure cost assessment is an essential component of this toolbox, providing the most reliable and robust results out of all of the cost assessment approaches considered in the methodology consultation.
- There are a number of significant advantages with the bottom-up, activity-level, disaggregated approach that mean that it produces significantly more reliable and robust results than the aggregated modelling approaches. In recognition of this, disaggregated modelling should be assigned a weighting that is greater than the combined weighting applied to the all of the aggregated models (i.e. top-down and middle model).

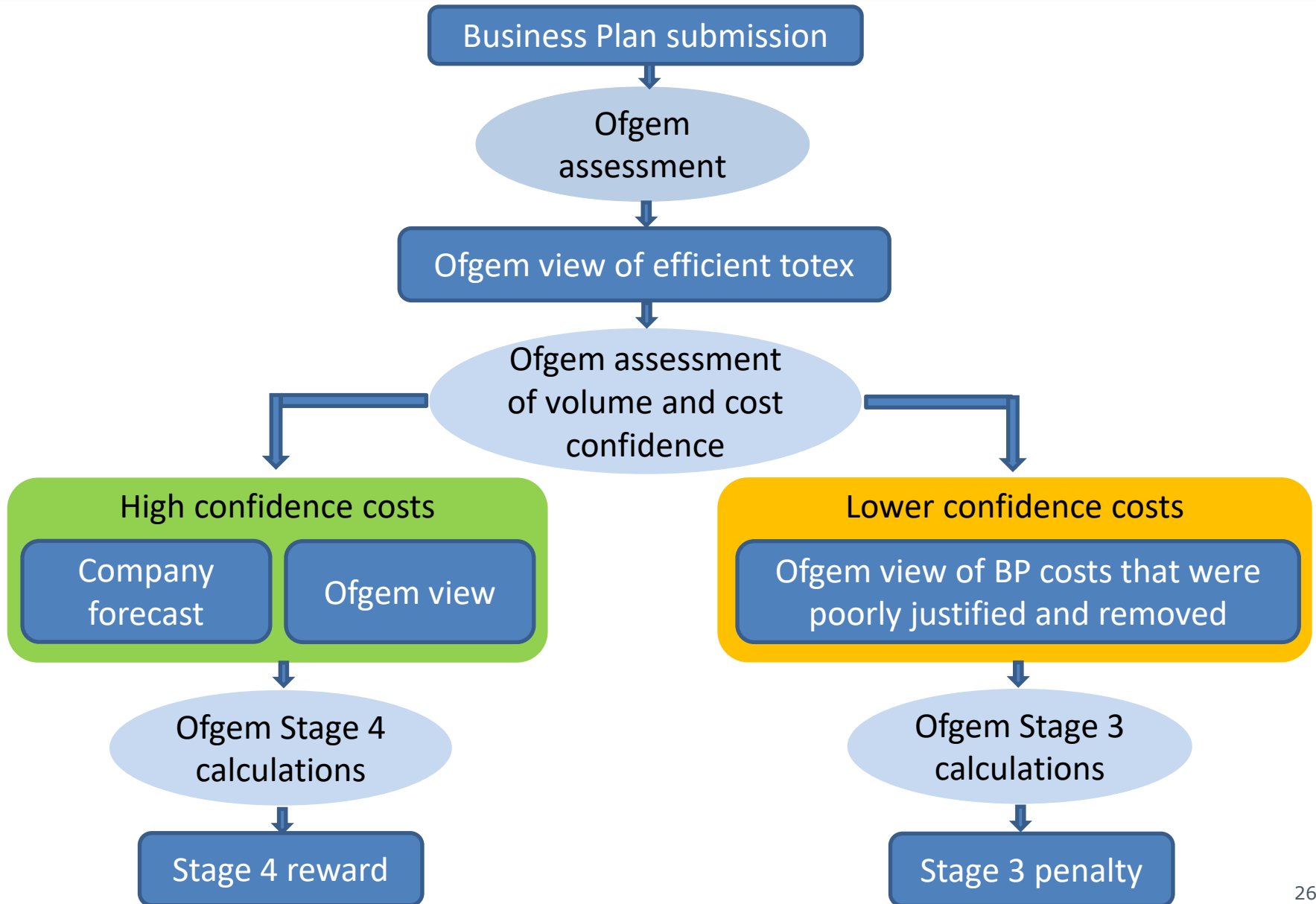
- Aggregated modelling does not identify whether a company's relative cost variance is driven by volumes of activity or efficiency of delivery. As a result, any allowance adjustment determined from aggregated modelling provides no transparency over how much of the adjustment relates to efficiency in the cost of delivery or volume adjustments.
- For the proportion of total allowances determined through aggregated modelling, the only reasonable approximation that can be used to disaggregate the allowances for PCDs, is to consider that any modelling adjustment applies uniformly to all costs within the assessed area of expenditure to which the adjustment applies.

Business Plan Incentive

The assessment of confidence in costs is critical to the outcome of BPI stage 3 and 4

The assessments of confidence in various elements of totex determine whether those totex elements are subject to a penalty under BPI stage 3 or earn a reward under BPI stages 4.

- High confidence cost elements in a company's BP can contribute to rewards under BPI stage 4, but not to penalties under BPI stage 3.
- Lower confidence costs in a company's BP can contribute towards penalties under BPI stage 3, but not to rewards under BPI stage 4.



- We appreciate that in the case of transmission there are many unique and bespoke projects where it is not possible to identify a comparative benchmark. However, in electricity distribution the work mainly consists of high volumes of low cost work carried out by a number of network operators. It is therefore more readily possible to have comparative analysis that allows the setting of independent benchmarks.
- Ofgem specifies in paragraph 13.7 that it will not determine which costs are high-confidence until after the receipt of business plans. In paragraph 13.6 Ofgem suggests a list of evidence that could be used to assist Ofgem in classification of costs as high-confidence. None of this guidance provides an indication of which cost areas would already be classified as high confidence, given that detailed disaggregated data has been reported for a number of years.
- We are concerned about the application of the high-confidence costs assessment.
- We are surprised by the outcome of the GD/T draft determination, where no reward has been proposed for this element of the BPI. We would have expected that some of the licensees would have proposed forecast high-confidence costs that are lower than the 'independent' benchmarks. This suggests that the benchmarking process may be being based on benchmarks that are not achievable.
- A reasonable benchmarking process would have some elements of some licensees' costs being better than a benchmark (unless frontier costs are being used for every element).

- We support the proposed design of the BPI for ED2 which is consistent with the approach taken for gas and electricity transmission and gas distribution sectors for RIIO-2. We note the additional guidance provided for the CVP element of the BPI and this is welcomed.
- The structure of the incentive is appropriate. Given the range of areas in which the BPI is meant to encourage the companies to provide better information, it may be necessary to consider whether the cap on rewards/penalties should be increased.
- In their Draft Business Plan submissions, DNOs should be required to state and explain the financial materiality of those elements of their submissions that could be affected by the decision on the Access SCR. In their Final Business Plan submissions, should be required to state and explain the financial materiality of those elements of their submissions that changed as a result of the Access SCR Final Decision. This additional information will allow stakeholders to better understand changes in their submissions not related to the Access SCR.

- Whilst the design of the BPI is reasonably clear, how Ofgem implements it in practice is not. From what we have observed of the implementation in the early RIIO-2 sectors, we are concerned that unless there are changes made for the application of the approach within RIIO-ED2 that there is a real risk of the BPI becoming a skewed incentive where companies only aim to avoid significant downside penalties.
- greater clarity is also required as to how high and low confidence costs will be determined. Given that no company in the GD/T DD was provided with a reward in stage 4 it would be helpful for Ofgem to provide a worked example so that companies can better understand how this stage is expected to work.
- We welcome Ofgem's acknowledgement that greater clarity is required in this area, and the consultation and associated guidance goes some way towards this. However, we would urge that dialogue on this important subject continues between now and the decision point in December 2020 via the formal working groups so that all stakeholders and companies can be clear on how this will work for ED in order to ensure maximisation of quality and ambition of business plans to deliver the best outcomes for consumers. These discussions should walk through each stage of the BPI and the interaction within and we suggest this is done at OAWG.

- We think it would be better if Ofgem was to introduce:
 - a) clearer prospects of material rewards for companies that submit plans based on challenging cost levels;
 - b) less focus on “discretionary” assessment by Ofgem of what constitutes a good plan, or the need to submit “value propositions” before seeing Ofgem’s assessment of the plans;
 - c) less emphasis on the distinction between high- or low-confidence costs, since this will distort incentives for companies to challenge themselves on costs across all of totex; and
 - d) sharing factors set based on the efficiency of company costs, rather than the proportions of the plan that fall in different pots.

- We require further clarity about Ofgem’s application of the BPI at stages 3 & 4. For all the areas below, it is essential that Ofgem provides further explanation and examples of the evidence it expects to be submitted and the way in which it would like information signposted. Without this clarity and greater transparency, resources will be wasted by DNOs preparing evidence that Ofgem will not consider and Ofgem may find it difficult to identify the information they would find useful. There is also an increased risk that Ofgem overlooks key information from the submissions.

- Assignment of cost categories as High or Low confidence: From the Draft Determinations in other sectors, we have learned that because Ofgem could benchmark more costs between the GDNs, they received a higher proportion of high confidence costs than the Transmission companies as they have fewer cost categories that can be directly compared. Ofgem indicated that companies could submit evidence to support the high confidence assessment, but all the detailed independent, high-quality evidence submitted by companies was effectively ignored. Clarity is therefore needed around exactly what Ofgem will accept as evidence in this area. If costs require to have a historical comparator to be judged as high confidence, this creates a bias against innovative solutions that cannot be benchmarked.
- Lower confidence costs Stage 3 penalty: DNOs will incur a penalty on lower confidence costs that are not 'thoroughly justified'. Clarity and greater transparency is needed from Ofgem on the evidence requirements to provide adequate justification.
- High confidence costs above the independent benchmark: Unless there is 'compelling evidence to the contrary' where costs exceed independent benchmark then Ofgem will set allowance at the level of the independent benchmark. Clarity and greater transparency is needed from Ofgem around what makes evidence 'compelling'.

- It is vital that Ofgem and DNOs work together in the appropriate ED2 working group to remove any confusion around the operation of the BPI. This will allow Ofgem to identify any required additional detail that needs to be added in relation to the BPI process, for the Sector Specific Methodology Decision in December 2020. We have serious concerns around how the BPI was applied by Ofgem in the other sectors at Draft Determination. As it stands, the current approach lacks the required transparency and the BPI did not fulfil its stated purpose of encouraging companies to submit ambitious business plans that represented genuine additional value for money compared to business as usual. The innovative and ambitious proposals from the other sectors were not rewarded in the way we would have expected them to have been under the BPI.
- As a general observation, we note that rewards have been extremely limited and that no company has earned a reward in stage 4 of the BPI. This suggests that the BPI incentive is skewed towards the downside, and we further note that similar levels of penalty are being proposed for companies that have and have not passed minimum requirements, suggesting a disproportionate approach to applying penalties. Overall, we question whether the BPI, as applied in RIIO-T2 and GD2, has achieved its stated aim and drives the right behaviours.

- Ofgem have not set out with sufficient clarity how the BPI will work for RIIO-ED2, in particular in relation to the stage 3 penalty mechanism. We think it is important that a clear process is set out early on and we would welcome worked examples from Ofgem to ensure we understand implication for our business plan. We are asking Ofgem to provide further clarity on at least the following points:
 - The extent to which projects removed from the baseline prior to stage 3 will nonetheless be subject to a penalty in stage 3;
 - How activities involving costs that Ofgem deem to be both “low-confidence” and “high-confidence” will be classified, and whether an entire activity will be classified as “low-confidence” even where not all costs involved are classified as such;
 - How costs associated with flexibility (non-wire) alternatives to managing distribution constraints will be treated. The associated markets are still maturing. We recommend Ofgem considers the classification of these costs based on the level of market testing DNOs are able to demonstrate as part of their business plans; and
 - How overheads associated with disallowed costs will be treated, to avoid unintended consequences and a disproportionate amount of overheads being disallowed
- We question the extent to which the design of the BPI genuinely allows for rewards, with the RIIO-T2 and GD2 Draft Determinations suggesting a skew towards the downside.

- The over-arching four stage design of the BPI appears to have some merit in principle. It makes sense to require minimum standards to be met (Stage 1) before contemplating reward for ambition (Stage 2). The approach to assessing cost (Stages 3 and 4) seems reasonable.

Role of Engineering Justification Papers (EJPs), CBAs



Potential EJP applicability

CAWG

19 November 2020

Stay connected...



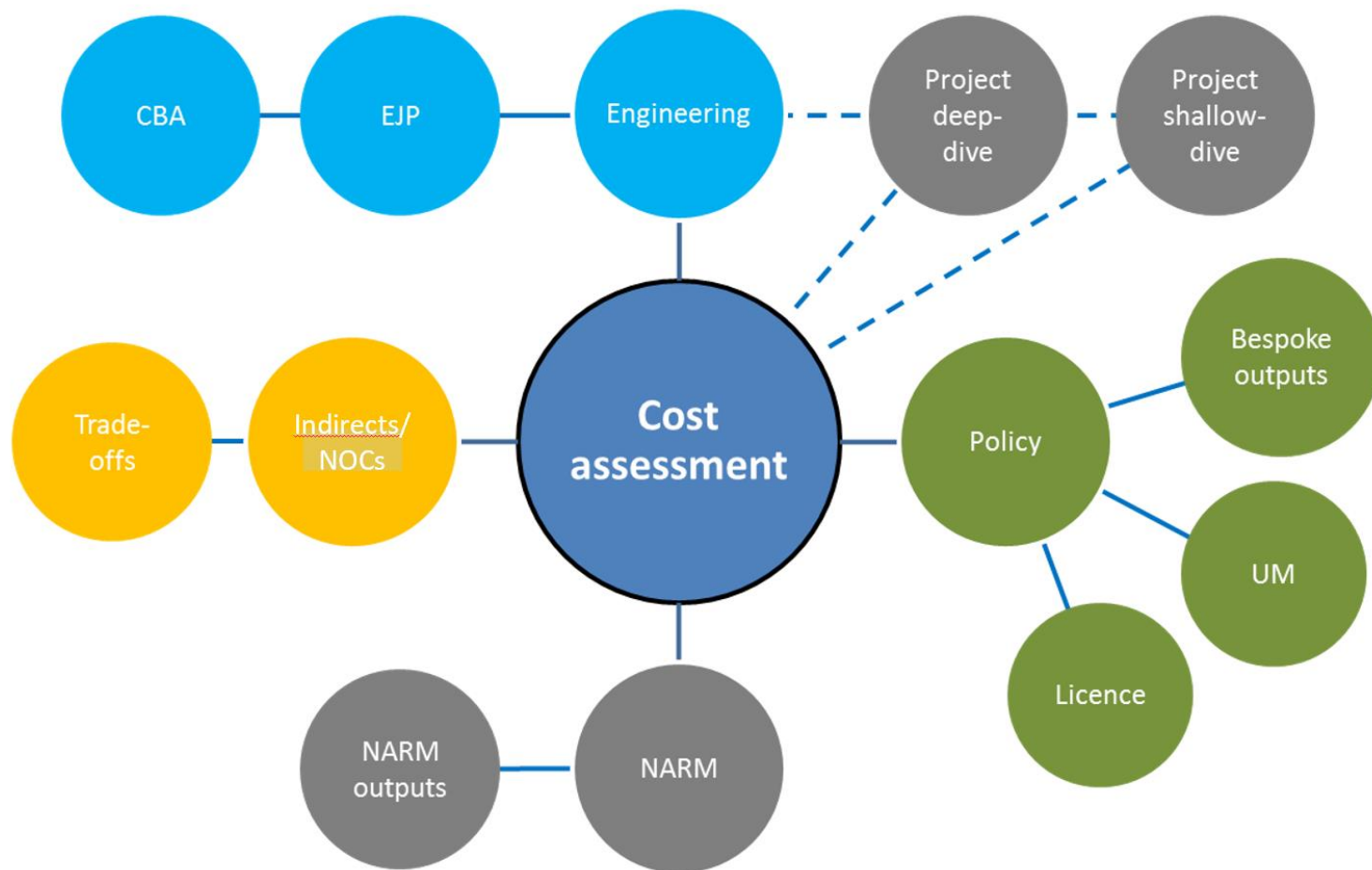
www.enwl.co.uk

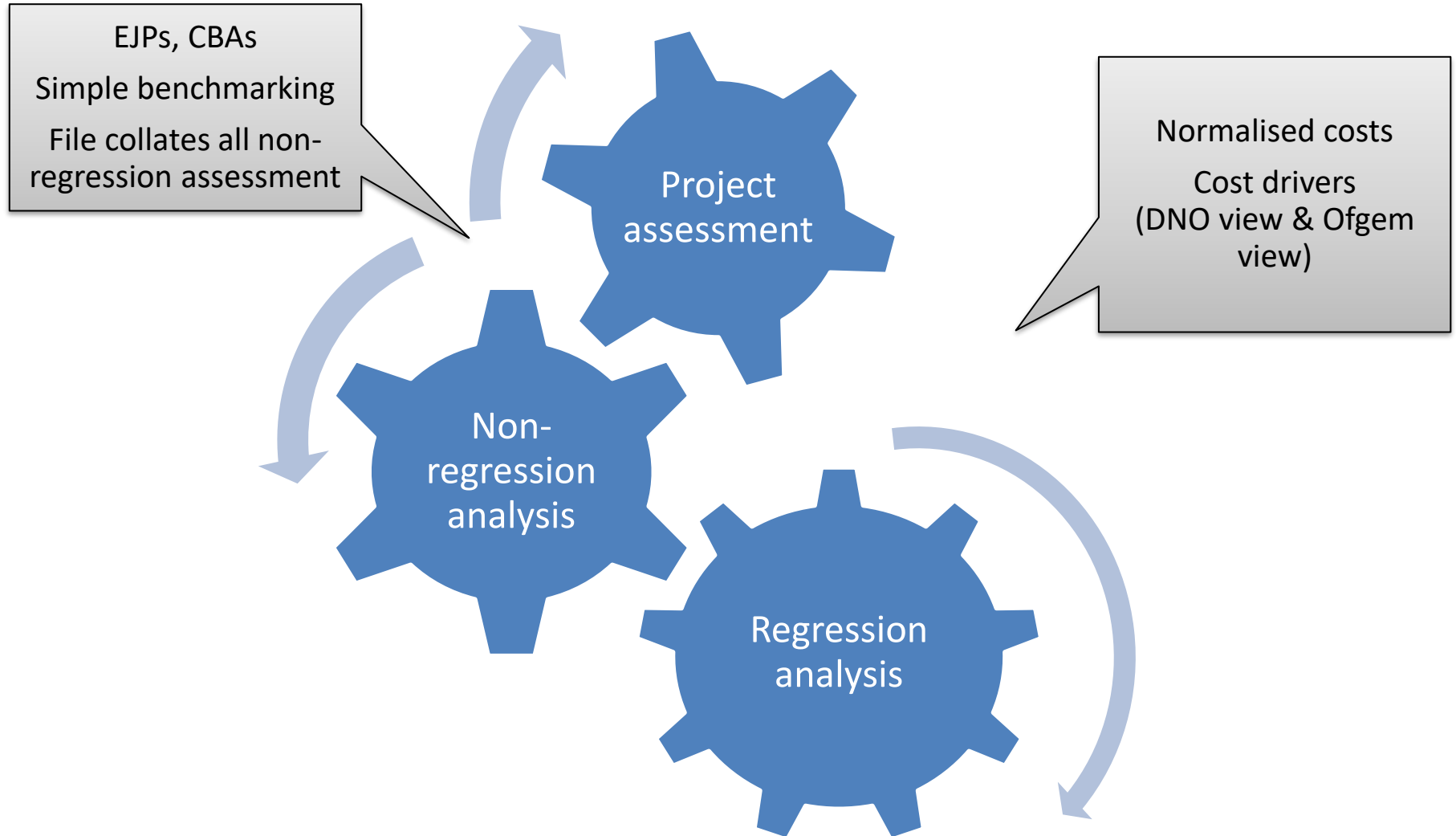
Potential EJP requirements by threshold



- We have been using £2m as an internal planning assumption for EJP thresholds
- Table shows indicative view of likely quantum by broad category and threshold
- Scale of many of the programmes still being developed in line with customer & stakeholder feedback
- Also dependency on what constitutes a distinct 'programme'
- Relationship with narrative, commentary and other forms of evidence to be considered
- And on the scope of EJPs across the cost base, eg Op IT? Telecoms? Innovation?

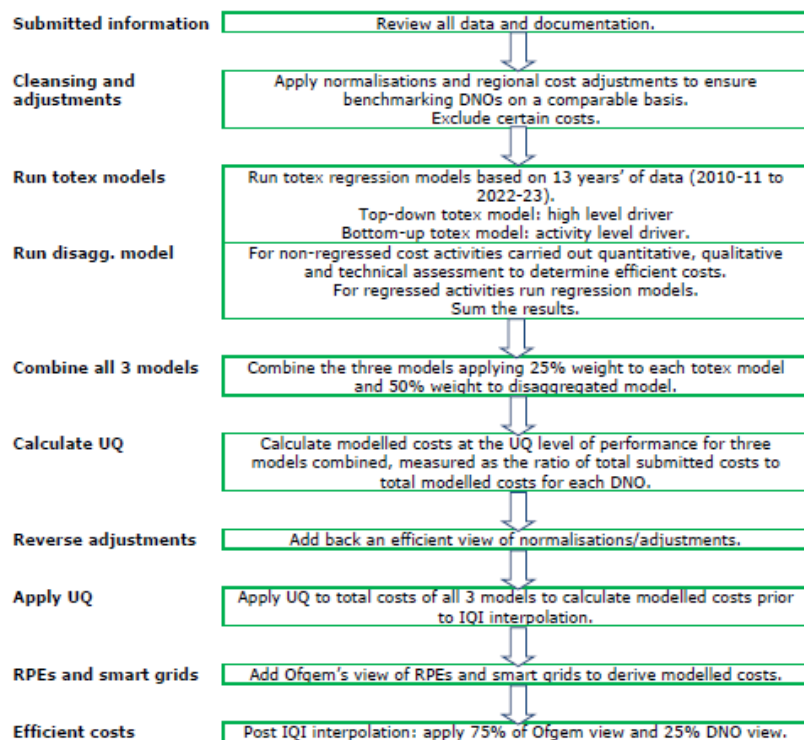
| | EHV & 132kV reinforcement | Non-load projects – Plant | Non-load projects - Circuits | Programmes | Total |
|---------|--|--|--|--|-------|
| >£25m | 0 | 0 | 0 | 0 | 0 |
| £10-25m | 0 | 2 – GSPs | 1 – 132kV oil cable | 29 – Non-NARMs (7), NARMs (7), Others (15) | 50 |
| £4-10m | 4 | 1 – large BSP | 3 – 132kV oil cable, 132kV Tower line, 33kV undergrounding | | |
| £2-4m | 3 | 2 – BSPs | 5 – 132 & 33kV oil cable, 132kV Tower lines | | |
| £1-2m | 14 (mostly fault level & very similar) | 24 – single GTs, Large Primary Boards etc. | 4 – 132kV Tower lines | 23 | 65 |



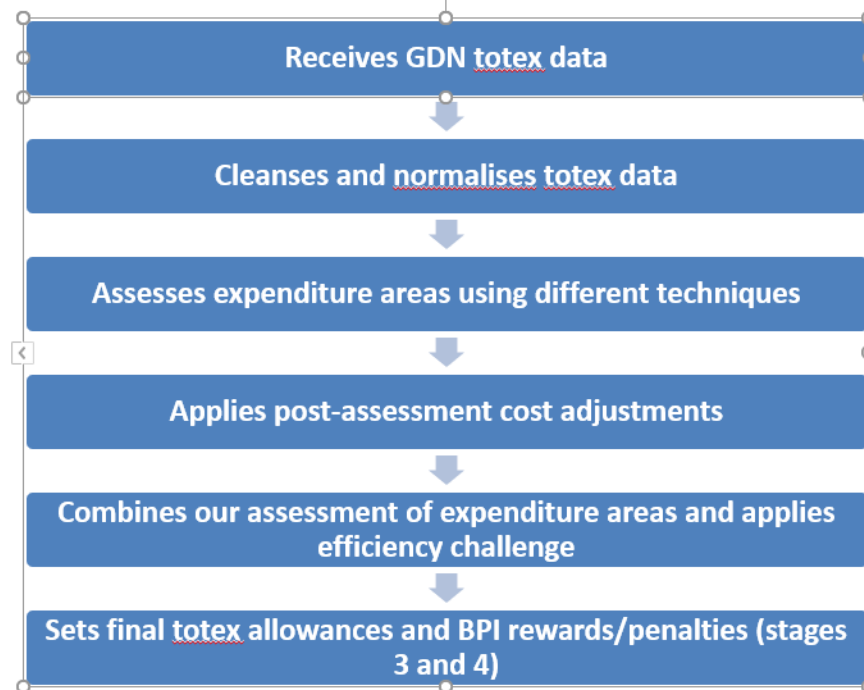


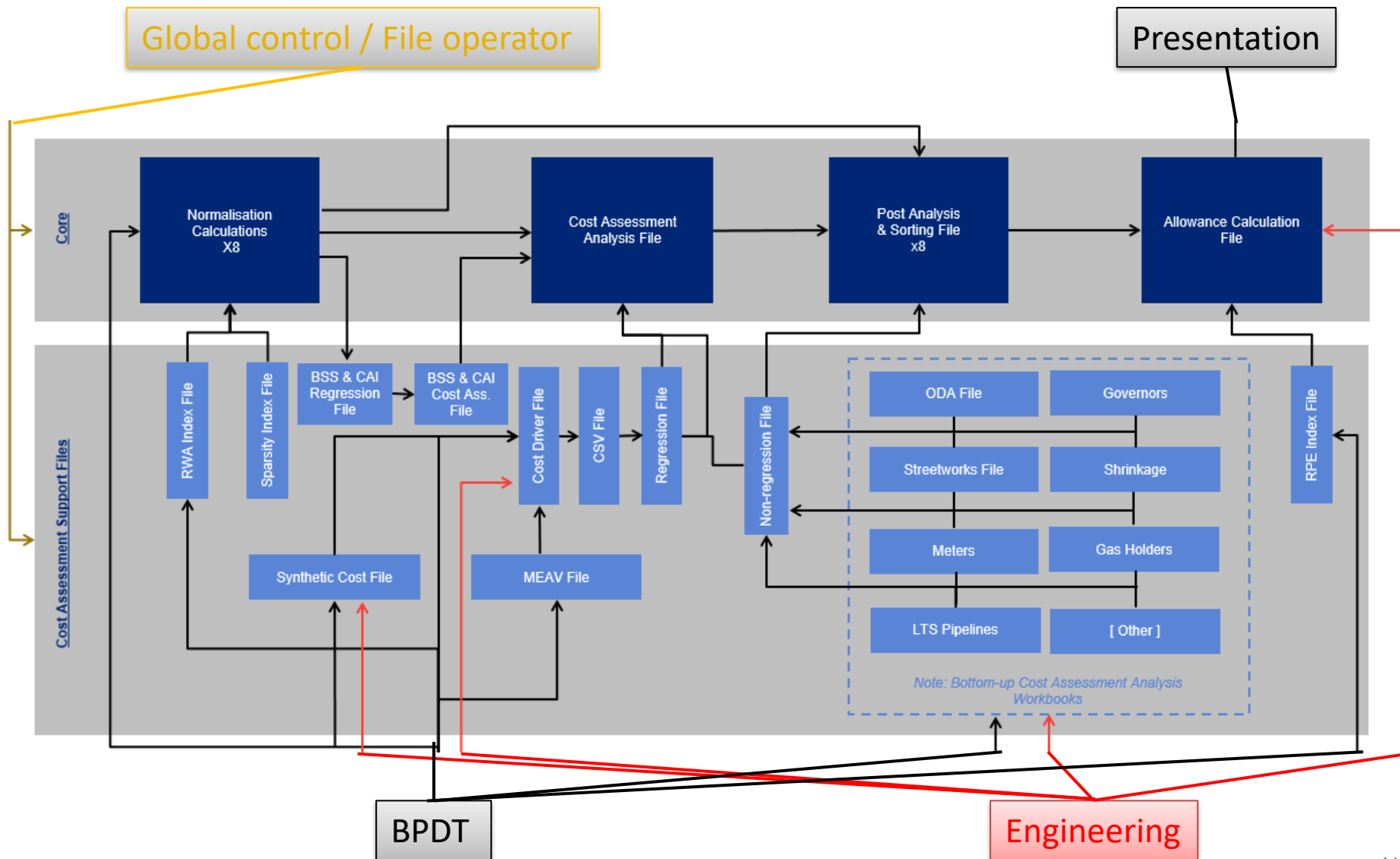
- Cost assessment diagrams for ED1 and GD2:

Figure 3.1: Slow-track approach



'Business critical' model





- Commit to update the current parameters as per ENWL presentation to the sub-group earlier this year.
- Target the inclusion of flexible factors for values to change over time, as happens with carbon in ED1, where this is appropriate to the parameter being considered.
- We aim to widen parameters to formally include benefits that go beyond the meter and wider societal benefit should be committed to in the SSMD. What badged as broaden the representative basket of benefits. Input required from companies in developing this.
- As in ED1 we will allow probabilistic assessment and account for it in BP guidelines that should companies want to use it to enhance decision making or assessment in areas of value. This should be additional to the agreed standard ED2 CBA.
- We will identify a firm date for when CBA updates and the CBA for ED2 will be complete to allow for the model to be used in anger in developing business plans. Propose to target **end of January**.

Actions, next steps, AOB

- The planned publication date for the RIIO-ED2 SSMD is on 17th December 2020
- We will circulate notes and an actions log from this meeting.