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| **Cadent Final Determination** | | | |
| **FDQ Query** | | | |
|  | | **SQ Reference number** | CADENT\_FDQ\_ | |
|  | | **Priority** | High | |
|  | | **Document Name** | Repex\_Synthetic\_Unit\_Cost\_Model | |
|  | | **Topic/Activity:** | Synthetic unit costs – repex mains | |
|  | | **Question:** | We are reviewing the synthetic unit cost model and would like to better understand the approach taken to apply the rules. Could you explain your approach (including rationale for the approach) to:   1. Choice of preferred unit cost and application of rule 3   In sheets Cal\_Repex\_SUC\_selection and Cal\_Services\_SUC\_selection, the approach makes a choice between the unit cost before rule 3 is applied or after rule 3 is applied, where rule 3 is the removal of GDN average GD1 & GD2 unit costs that are 40% greater than the relevant industry average.  It is not clear from the logic in the sheet how the preference between the two sets of unit costs is being decided. For example, for Associated Relay Domestic services the spreadsheet returns the preferred unit cost as after rule 2 is applied rather than post rule 3. However, if we review the results of the rules, it is clear that some observations fail the rule three test and therefore we assumed rule 3 would be applied but it hasn’t. Instead the spreadsheet accepts the unit cost before rule 3 is applied if 25% or fewer of the observations fail the rule 3 test. This is repeated throughout the selection of repex and services unit costs. Could you please explain the approach.   1. Application of rule 4   Could you explain your approach to the application of rule 4. As we understand it, rule 4 is intended to remove individual unit costs that are assessed to be greater than 40% away from the industry average. In the synthetic unit cost model, the rule 4 is applied in sheets Cal\_Repex\_SUC\_selection and Cal\_Services\_SUC\_selection and instead of removing individual unit costs that fail this rule, it instead assesses whether greater than 25% of the observations fails the rule and if yes a scaling factor is used to calculate the unit cost. Could you please provide more information to explain the approach and rationale behind it.   1. Scaling factors   For Associated Services Relay Non-Domestic you have used a scaling factor based on the newly calculated synthetic unit costs for the Associated Services Transfers rather than the approach taken for mains which is it to use calculate scaling factors based on the synthetic unit costs used at GD1. This is also out of line with the approach described in para 1.47 of the step by step guide. Can you please explain the deviation in approach. | |
|  | | **Confidential** | No | |
|  | | **FDQ raised by** | Kate Haycock | |
|  | | **Date Sent** | 8 January 2021 | |
|  | | **Response Due Date** | 9 January 2021 | |
|  | | **Attachments:** | | |
|  | | **Response to Cadent:**  1. The logic of the formulae in the synthetic unit costs selection sheets is:  - if the synthetic unit cost calculated after applying rule 2 passes rules 1-4, use that as the synthetic unit cost;  - if it doesn’t, but the synthetic unit cost calculated after applying Rule 3 does, then use that as the synthetic unit cost;  - if even that doesn’t pass some of the rules, use a scaling factor.  In determining whether rules passed or failed, we adopted the pragmatic approach recommended by our economic consultants. As noted on p. 18 of the *RIIO-GD2: Synthetic Unit Costs Update* Annex to Draft Determinations, “we apply a pragmatic approach to determine whether this criterion passes for each activity. A pass is assigned if less than 10% of GDNs unit costs are beyond the threshold. A partial pass is assigned if between 10% and 25% of GDNs unit costs beyond the threshold. A fail is assigned if more than 25% of GDN unit costs are beyond the threshold.”  2. For rule 4, we have applied the same pragmatic approach described in point 1.  3. Where no obvious scaling factor could be identified based on RIIO-GD1 synthetic unit costs, we computed it based on a set of synthetic unit costs that passed the rules. | | |