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| **Cadent Final Determination** | | | |
| **FDQ Query** | | | |
|  | | **SQ Reference number** | CADENT\_FDQ\_ | |
|  | | **Priority** | High - Technical Error | |
|  | | **Document Name** | FD modelling suite | |
|  | | **Topic/Activity:** | Pay normalisation | |
|  | | **Question:** | We believe that we have found 3 errors in the pay normalisation, in respect of:   1. The labour proportion of all opex activities 2. The labour proportion of ODA 3. The London uplift calculation   Taking each in turn:   1. **The labour proportion of all opex activities**   We observed that the labour proportions of opex activities at FD were substantially below those at DD: for example, Emergency comprised 84.9% labour at DD but only 75.8% at FD.  The drop has occurred because, at FD, labour %s of zero are shown for Opex activities against Cadent GDNs for 2019/20 and 2020/21 – two years out of the thirteen used.  These have been shown as zero because, in Cadent’s abbreviated updated BPDTs provided in the Autumn, we blacked out all the details of opex cost breakdowns, given that there was not a material change in cost composition since the December 2019 BPDTs were submitted.  We believe that there are two options to correct this:   * Apply the labour percentages from the original BPDTs, as used at DD * To use revised opex cost split data for 2019/20 and 2020/21, which Cadent would provide   Either solution would be reasonable, but the first has the advantage of being quicker to implement and we had previously assessed the change in split as immaterial (hence the abbreviated submission).  Please confirm that you agree this is an error, and advise which solution you intend to implement.  The file reference is LabourRatios file (1): tab Cal Labourratios adjusted, rows 14-812.   1. **The labour proportion of ODA**   As we first commented in our Autumn checking of Ofgem’s post DD revised modelling files, there is a material change in the composition of ODA between GD1 and GD2, so that it is not accurate to use the 13 year average labour of 11% in the FD to apply to the RIIO-2 period.  Three changes in the composition of ODA are relevant:   * First, Xoserve costs, which made up around 50% of ODA costs in GD1, and are considered 0% labour, are moving to Non-controllable costs. This will significantly increase the ODA labour proportion. * Second, Pension Scheme Administration costs, which we have estimated as 75% labour, are moving from Non-controllable to controllable costs. These are less material than Xoserve costs but will still increase the ODA labour proportion. * Third, PPF levy costs, with a zero labour element, are moving from Non-controllable to controllable costs. These are very small but will act to reduce the ODA labour proportion.   We estimate that adjusting for these changes in the RIIO-1 costs will increase the 13 year average labour proportion of ODA costs to around 22%.  Please confirm that you agree this is an error.  The file reference is LabourRatios file (1): tab Cal Labourratios adjusted, rows 375-411.   1. **The London Uplift calculation**   At the DD, the London pay uplift for RIIO-2 was calculated using data for 2013/14 to 2017/18 – GD1 actuals, less the most recent year for which Ofgem did not have population data.  At FD, the London pay uplift is calculated using data for 2014/15 to 2018/19.  We agree that the year 2018/19 should be included in the calculation, but we believe the exclusion of 2013/14 is an error. We can see strong logic for using the most recent years – 2017/18 and 2018/19 as we proposed in our DD response – and some logic for GD1 actuals – 2013/14 to 2018/19, the same start point as the calculation of labour percentage calculation as identified above. As such, we think the exclusion of 2013/14 is a Technical Error.  Please confirm whether the use to 2014/15 to 2018/19 for the London pay uplift in RIIO-2 is an error.  The file reference is the RegionalCostIndices file (1): tab *Cal Labour Indices*, rows 82-89. | |
|  | | **Confidential** | No | |
|  | | **FDQ raised by** | Jeremy Thomson | |
|  | | **Date Sent** | 16/12/2020 | |
|  | | **Response Due Date** | 21/12/2020 | |
|  | | **Attachments:** | | |
|  | | **Response to Cadent:**  **1.** Thanks for pointing this out. We confirm this is an error, which we will address. As a default option, we’ll consider December BPDTs.  **2.** Our intent was to apply consistency of time period approach across all aspects for FD, but upon further reflection we agree the difference in cost structure for ODAs between RIIO-GD1 and RIIO-GD2 periods reasonably justifies a difference in approach here and we will use a RIIO-GD2 only measure in the final error corrected FD model run.  **3.** This is not an error. We consider using of a 5-year average achieves a balance between using the most updated information (extending to 6 years would have resulted in assigning a higher weight to less relevant years) and avoiding biases due to year-on-year variations (this would have been the case if we only used the last two years). | | |