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| **Cadent Final Determination** | | | |
| **FDQ Query** | | | |
|  | | **SQ Reference number** | CADENT\_FDQ\_  19\_FQ | |
|  | | **Priority** | High | |
|  | | **Document Name** | [9]Allowances\_File\_GD\_noRPEs and [9]Allowances\_File\_GD\_incRPEs | |
|  | | **Topic/Activity:** | Application of glidepath to derive allowances | |
|  | | **Question:** | We have identified an error on the application of the glidepath to derive allowances, which results in allowances being too high in the first half of GD2 and too low in the second half of GD2.  In the file [9] Allowances\_File\_GD\_noRPEs, the glidepath is calculated in the sheet Cal\_EfficientCosts (rows 53 – 60). This is then picked up in row 12 of the GDN specific allowances sheets (e.g. Cal\_EoE). However, the totex profile is not maintained in the disaggregation of totex or the application of the frontier shift. Instead the sheet takes the percentage difference between total modelled costs (post catch up efficiency challenge) and the total modelled component of submitted costs and applies this to the disaggregated submitted costs.  As a result, the allowances in first two years of GD2 are more generous than intended, and in the last two years of GD2 are more challenging than the 85th percentile. For example, for our London network the approach results in allowances that are in total £51m too high in the first two years, and £51m too low in the last three years.  The table below illustrates this issue and compares the glidepath calculated in Cal\_EfficientCosts to the profile used to calculate allowances. Note the costs in the table are modelled costs (post catch up efficiency but pre-ongoing efficiency).   |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | |  | **2022** | **2023** | **2024** | **2025** | **2026** | **Total** | | **Glidepath in Cal\_EfficientCosts** | | |  |  |  |  | | EoE | 306.14 | 315.79 | 324.76 | 315.18 | 299.10 | 1,560.98 | | Lon | 212.27 | 233.79 | 259.19 | 256.39 | 256.26 | 1,217.89 | | NW | 228.23 | 228.62 | 230.09 | 220.63 | 200.87 | 1,108.44 | | WM | 160.60 | 170.61 | 188.19 | 184.51 | 179.97 | 883.88 | | NGN | 240.77 | 239.79 | 239.61 | 239.25 | 234.12 | 1,193.53 | | Sc | 174.23 | 175.27 | 175.12 | 173.84 | 172.04 | 870.50 | | So | 359.46 | 361.12 | 359.32 | 355.17 | 354.07 | 1,789.15 | | WWU | 236.32 | 238.40 | 238.85 | 237.77 | 237.02 | 1,188.37 | |  |  |  |  |  |  |  | | **Glidepath in Allowances sheets (e.g. Cal\_EoE)** | | | |  |  |  | | EoE | 319.31 | 318.66 | 319.03 | 306.73 | 297.25 | 1,560.98 | | Lon | 248.59 | 248.67 | 246.97 | 239.68 | 233.99 | 1,217.89 | | NW | 230.55 | 229.96 | 225.30 | 213.80 | 208.83 | 1,108.44 | | WM | 178.97 | 179.11 | 181.72 | 173.08 | 170.99 | 883.88 | | NGN | 239.10 | 241.49 | 239.10 | 238.04 | 235.79 | 1,193.53 | | Sc | 174.91 | 182.42 | 174.62 | 169.62 | 168.93 | 870.50 | | So | 350.21 | 363.75 | 363.23 | 356.99 | 354.98 | 1,789.15 | | WWU | 247.28 | 236.40 | 232.62 | 235.06 | 237.02 | 1,188.37 | |  |  |  |  |  |  |  | | **Difference** |  |  |  |  |  |  | | EoE | 13.17 | 2.87 | -5.73 | -8.46 | -1.86 | 0.00 | | Lon | 36.32 | 14.88 | -12.22 | -16.71 | -22.27 | 0.00 | | NW | 2.32 | 1.35 | -4.79 | -6.83 | 7.96 | 0.00 | | WM | 18.37 | 8.50 | -6.47 | -11.43 | -8.98 | 0.00 | | NGN | -1.67 | 1.71 | -0.50 | -1.20 | 1.67 | 0.00 | | Sc | 0.67 | 7.16 | -0.50 | -4.23 | -3.11 | 0.00 | | So | -9.25 | 2.62 | 3.90 | 1.82 | 0.91 | 0.00 | | WWU | 10.96 | -2.01 | -6.23 | -2.71 | -0.01 | 0.00 |   Could you please confirm this is an error and provide a corrected allowances file. | |
|  | | **Confidential** | No | |
|  | | **FDQ raised by** | Kate Haycock | |
|  | | **Date Sent** | 11 January 2021 | |
|  | | **Response Due Date** | 14 January 2021 | |
|  | | **Attachments:** | | |
|  | | **Response to Cadent:**  Our application of a scaling factor to submitted costs results in a time profile for the allowances in line with submitted costs. We deemed this approach to be appropriate. Therefore, our view is this is not an error. | | |
|  | | **Further response from Cadent:**  Could you please reconsider this issue, as the approach you have taken is inconsistent with the statements in the GD annex regarding the approach to the glidepath, in particular, paragraph 3.25 of the GD Annex states:  *“However, after further consideration since Draft Determinations, we have decided to set benchmarking efficiency as a glide path from the 75th percentile in the first year of RIIO-GD2 to the 85th percentile over a three-year period.* ***This will provide a continuum from the level of efficient performance the GDN’s committed to achieve by the end of RIIO-GD1 and the 85th percentile will thus only apply to the last two years of the price control.”***  The consequences of the treatment you have outlined are as follows:   * It means that customers pay too much for the first half of RIIO2 and to little for the second half of the price control. * this also creates problems for reporting of performances against allowances which will be distorted creating issues for Ofgem and Networks in explaining and justifying performance * it creates potential cliff edges in bills for RIIO3 where the costs would likely need to increase to the corrected level again impacting customers.   Through the course of our engagement our customers placed a great deal of focus on predictable and stable bills over time and given this (and the wider changes that are needed to charges via the errata process) we do not understand the logic for not correcting the error. | | |
|  | | **Response to Cadent:**  On the call on the 14th of January 2021, we further clarified that this is not an error. Our approach for Final Determinations ensures that the time profile of the allowance is consistent with that of submitted costs, and thus with the GDNs’ level of work in each year of RIIO-GD2. | | |