

## Cost Assessment Working Group – Meeting 15

From: Ofgem

Date: 14<sup>th</sup> August 2020

Time: 9:30 – 12:00

Location: Teleconference

### 1. Present

Ofgem  
Cadent  
NGN  
SGN  
WWU

### 2. Real price effects (RPEs) and ongoing efficiency

- 2.1. Ofgem highlighted an error in their Draft Determinations (DD) consultation relating to RPEs, where the index compounding calculation incorrectly omitted the last two years of RIIO-1. Ofgem confirmed that they have added it to the error log, and will correct this before Final Determinations (FD).
- 2.2. Ofgem requested that GDNs use their DD responses to clearly highlight any perceived issues with our judgement, and propose an alternate approach where possible and clearly demonstrating how this drives additional consumer benefit. One stakeholder explained that some of the proposed indices may be more costly, but may be beneficial to consumers as a result of being more accurate.
- 2.3. One stakeholder noted that the proposed materials indices appeared to contain large proportions of labour costs. The stakeholder noted that FOCOS indices are more in the public domain than RICS indices, and therefore may offer a better starting point for materials indices. Ofgem suggested that this be clearly articulated in the DD response, and suggested that this topic could be discussed again at a future CAWG following DD. Another stakeholder welcomed this suggestion and expressed a view that the DD did

not explain clearly enough how GDN proposals were taken on board. There was general support among other stakeholders for this topic to be discussed at a future CAWG.

- 2.4. Ofgem noted that it would be helpful if the GDNs could provide any additional information in support of the issues previously noted on indices. There was concern among stakeholders that without understanding the rationale behind how indices were assessed and selected for DD, they would find it difficult to provide further compelling evidence.
- 2.5. In relation to the ongoing efficiency range proposed by CEPA, a stakeholder queried Ofgem's rationale for adopting the upper end of that range at DD. Ofgem stated that the rationale had been presented as part of DD and so is open to consultation.
- 2.6. In relation to the proposed 0.2% of ongoing efficiency linked to past innovation, there was a discussion on what supporting calculations were available. Ofgem noted that the approach to calculating the proposed 0.2% was outlined in DD. A stakeholder asked that Ofgem share any supporting calculation files with the group.
- 2.7. The group discussed several actual and perceived errors in DD that companies had identified.

### **3. Disaggregated model allowances**

- 3.1. A stakeholder asked if Ofgem could share the disaggregated allowances model. All GDNs agreed they would like to see the model. No issues with confidentiality were raised in relation to sharing the model with GDNs.
- 3.2. A stakeholder raised concern over the methodology for disaggregation of repex costs and how they interact with the Tier 1 PCDs. Stakeholders suggested that a consistent approach was required to ensure unit costs capture the efficiency challenge. Ofgem stated that GDNs should highlight any specific concerns on the methodology presented and propose solutions.

- 3.3. One stakeholder asked about the repex funding mechanism. Ofgem stated that the unit costs derived from bottom up assessment are proposed to be used in the repex funding mechanism, and clarified that an adjustment to repex allowances would be based on difference in outturn workloads mix, rather than a change in unit costs. Ofgem added that the next repex working group will cover this topic. Another stakeholder asked if the material from the repex working group on this topic (including the interaction with the Network Asset Risk Metric and the Totex Incentive Mechanism) could be shared with the attendees of this meeting. Ofgem agreed to this request.
- 3.4. One stakeholder stated that it is very late in the DD consultation to be receiving new information, and that more time will be needed to respond to additional information. The stakeholder also raised concern that they have not heard any detail from Ofgem about a process for receiving feedback after the DD consultation closes.
- 3.5. One stakeholder asked if Ofgem is considering another consultation stage. Ofgem stated that this issue has been raised with the Ofgem leadership team, and it will be discussed in other engagement forums including the executive bilateral meetings. Ofgem clarified that the 4th September consultation deadline still stands.

#### **4. Modern equivalent asset value (MEAV)**

- 4.1. One stakeholder raised an issue with multiple occupancy building (MOB) values from other companies. Another stakeholder argued that they have full confidence in their submitted MOB values, and have provided evidence to Ofgem to explain differences between their business plan MOB values and their reported values in the RIIO-1 regulatory reporting packs. Stakeholders asked if they could see this evidence.
- 4.2. Two stakeholders asked if MOB data was included in Ofgem's MEAV calculation. The stakeholders noted that the DD publication states that MOB's are included in MEAV, but that they can't see evidence of this in the model. Ofgem agreed to clarify whether they are included.

4.3. One stakeholder stated that they think there are inconsistencies in how MOB's have been populated in the business plan data tables (BPDTs) between companies and that this also affects MEAV.

4.4. Stakeholders asked when the next model run would take place, and Ofgem confirmed that it would be done after the DD consultation period so that all comments can be collated, and all required adjustments made at once.

## **5. Modelling errors**

5.1. Ofgem presented a new model error log to capture all model errors in one place for easy access and tracking. Ofgem discussed the outstanding errors in the log and their materiality. Ofgem stated that they can share updated versions of the error log again over the next few weeks. GDNs agreed it was helpful to have a log which summarised all ongoing corrections in one location.

5.2. A stakeholder asked if the ongoing efficiency and RPE errors affect regression results. Ofgem confirmed that both of them don't affect the regression modelling results as they are defined outside of the totex regression modelling at the last stage and therefore only affect values from License Model.

5.3. A stakeholder asked if Ofgem could prioritise answering GDN's questions on the DD consultation (DDQs) relating to synthetic unit cost calculations. Ofgem agreed to prioritise these DDQ responses.

5.4. Ofgem asked for feedback from the GDNs on the introduction of a deadline to raise DDQs. One stakeholder mentioned that they understood the requirement of a deadline to meet upcoming milestones, however would want to be able to raise any important issues as and when new information comes to light. Ofgem encouraged GDNs to still raise potential errors they identify even post the DDQ deadline. Ofgem mentioned that they will aim to respond to most DDQs by the end of the week however some DDQs

will not be answered during the consultation period, especially when relating to difference of opinion on DDs.

## **6. Running the RIIO-GD2 totex model**

- 6.1. One stakeholder highlighted that disallowed workloads for the RIIO-GD2 period haven't been adjusted for in the totex composite scale variable (CSV) used in the regression. There was a discussion around whether adjustments could be made at different points of the modelling process. Ofgem noted that there are potentially different ways to approach the modelling process and that it was interested to hear stakeholder views of how adjustments could be made to cost drivers.
- 6.2. One stakeholder suggested that GDNs should be allowed additional leeway beyond the 4<sup>th</sup> September to respond on issues relating to running the model as some files were only received recently. Ofgem agreed that this was fine for issues relating to running the models.

## **7. Future CAWGs**

- 7.1. Ofgem stated the intention to hold the next CAWG in the week commencing the 14<sup>th</sup> September, between one and two weeks after the DD consultation closes, as an opportunity for the group to come back to some of the main concerns raised in the consultation responses. Ofgem explained that they are trying to strike a balance in allowing for the right level of engagement to give the opportunity for the highest level of confidence in the modelling. Ofgem explained that they want to hear the views of stakeholders, but too many iterations of discussion will not be practical or even possible before the publication of FDs. Ofgem stated that after the September CAWG, there will not be time for many more iterations of discussion, and this might be most useful in the bilateral form.

- 7.2. One stakeholder raised concern that there will be too much change in the model between DD and FD. Another stakeholder agreed, stating that without any reinstatement of numbers, the difference from DD and FD models would be large.
- 7.3. Ofgem stated that they will not produce an intermediate model run to circulate to stakeholders between DD and FD, and instead will focus on ensuring the FD model uses the correct data, in the right way. Ofgem stated that in addition to time constraint, there is concern that publishing an intermediate model run would lead to stakeholders reviewing and commenting on aspects of the model or model outcome that are not necessarily reflective of the FD approach.