

## Cost Assessment Working Group – Meeting 16

From: Ofgem

Date: 16/09/20

Time: 10:30 – 13:30

Location: Teleconference

### 1. Present

Ofgem  
Cadent  
NGN  
SGN  
WWU

### 2. Multiple occupancy buildings (MOBs)

2.1. Ofgem asked an update on the GDNs' discussion on MOBs reporting. One stakeholder noted that they are preparing some slides to share with the other GDNs before sending to Ofgem, and anticipated the presence of inconsistencies in reporting, which in turn cast doubts on the inclusion of MOBs in MEAV. The stakeholder also highlighted the need to be careful about the implications of the inclusion of MOBs in the modern equivalent asset value (MEAV) on allowances.

2.2. Another stakeholder noted that the inclusion of MOBs in MEAV is justified by the need to get a better scale measure, and that the purpose of the exercise is get consistent figures. The stakeholder also pointed out two specific consistency points to be addressed: the absence of MOBs in one GDN's business plan data tables (BPDTs) and the change in one GDN's figures compared to their RIIO-1 regulatory reporting packs (RRPs).

2.3. One stakeholder commented that there is still a more general issue that the GDNs define MOBs slightly differently.

2.4. Ofgem asked the GDNs when they would be able to share the results of the collective work. The GDNs discussed potential timelines and proposed to send their collective view towards the end of w/c 21<sup>st</sup> September.

### **3. Model assurance – GDN review**

3.1. Ofgem asked for feedback on the proposed timeline for model review by GDNs.

Stakeholders welcomed the opportunity to review the models, and agreed that it is a necessary step to help increase confidence in the models and the data inputs. Two stakeholders raised concern that a thorough review of all models will be difficult in the proposed timeline. One stakeholder suggested prioritising the most material models first. Ofgem agreed to circulate an updated timeline based on this discussion.

3.2. A stakeholder asked if there is any additional external assurance taking place on the models. Ofgem clarified that there is additional internal and external assurance taking place.

### **4. Use of latest RRP data**

4.1. The group discussed whether the forecasts for the last year of RIIO-GD1 (2020/21) include COVID-19 implications. All GDNs confirmed that their forecasts submitted in the RRP are pre-COVID forecasts.

4.2. The group then discussed their views on whether the latest RRP data should be used in the RIIO-GD2 models. One stakeholder stated that in theory, the latest and best forecast data should be used. The group agreed with this view, although several stakeholders raised concern over the practicality of achieving this. Ofgem stated that the data would need to be submitted in the BPDT format, and converted into the right price base. A stakeholder noted that they would not be able to re-submit a whole BPDT in time.

4.3. Ofgem asked for views on updating the data where practical and material. One stakeholder stated that ideally, the whole BPDT would be resubmitted for consistency,

but that they do not think all the granular data is needed in the models. Another stakeholder suggested that Ofgem identify the parts of the BPDT they need resubmitting.

## **5. Synthetic unit costs**

- 5.1. Ofgem asked the group for their views on the level of aggregation of categories used in the synthetic unit cost calculations. There was a brief discussion on the potential changes to the categories presented, and several stakeholders suggested that this should be picked up in the next repex working group instead, where engineers are also present.
- 5.2. One stakeholder suggested that it would be useful to find out what is causing the differences in repex synthetic unit costs between RIIO-GD1 and RIIO-GD2.

## **6. Opex trade-offs with disallowed repex and capex**

- 6.1. Ofgem outlined the approach used in RIIO-GD1 to adjust opex workload to account for disallowed repex workloads. Some stakeholders stated that they need more time to review the information presented, and suggested that they could circulate comments to the group in the next week. One stakeholder noted that the disallowed repex overheads should also be considered, and pointed out differences in overheads across the GDNs due to different allocation methodologies or different contract types. Ofgem stated that they would send a supplementary question to all GDNs to gather any additional information required on the overheads.
- 6.2. Ofgem noted that a similar issue occurs for any disallowed capex projects. One stakeholder agreed with Ofgem's suggestion to consider the impact of disallowed projects on opex on a case by case basis.

## **7. Disaggregation methodology**

- 7.1. Ofgem asked the group for feedback on the viability of applying separate totex scaling factors to costs assessed through regression versus non-regression techniques. One

stakeholder explained that it would make sense to apply separate scaling factors, and gave an example of where, in some cases, non-regression assessment could result in bigger cost cuts, yet are awarded higher allowances through disaggregation using a single scaling factor. Another stakeholder agreed with this position, but noted that this issue could also be resolved by changing the modelling approach to include top-down and bottom-up models.

- 7.2. A stakeholder explained that there could be instances of a GDN that is behind the frontier at a totex level, and therefore incurs a catch-up challenge, and yet that same GDN could be a frontier in a single category, for example repex. Using a single scaling factor would result in that GDN's repex allowances being reduced in-line with overall totex, ignoring the fact that they are already a frontier performer in repex.
- 7.3. A stakeholder noted that whilst there were challenges relating to totex disaggregation, they would not support a move away from the general totex modelling principals. They noted that they didn't see these issues as warranting a move to a more bottom-up approach, and believed that assessing totex costs top-down was the right general approach.
- 7.4. A stakeholder stated that whilst more weight should be placed on totex compared to bottom-up, having different pictures was still important. They also noted that they thought technically assessed costs had been treated inconsistently at DD, and explained that costs were funded through an uncertainty mechanism for some networks but not others.

## **8. Non-controllable costs**

- 8.1. Ofgem asked the group for their views on updating the exit capacity pass through costs ahead of final determinations to reflect the approval UNC0678, which will take effect on the 1<sup>st</sup> October 2020. Two stakeholders stated that there will be material increases to their exit capacity costs, and they are happy to provide updated cost

forecasts. Ofgem highlighted that the costs will be trued up during RIIO-GD2, but stated that GDNs have the opportunity to submit updated forecasts by end of September for inclusion in the final determination.

## **9. Real price effects (RPEs) and ongoing efficiency (OE)**

- 9.1. Ofgem presented the key issues raised in DD responses for both RPEs and OE.
- 9.2. Noting the size of the topic, one stakeholder thought that a designated RPE/OE session would be appropriate, rather than attempting to cover everything in the CAWG. Another stakeholder supported the prospect of a separate call.
- 9.3. One stakeholder suggested that Ofgem and the group revisit the basic principles of what makes a good index. They noted that having reviewed all Ofgem's proposed indices, some failed to meet Ofgem's selection criteria, and explained that they had found more suitable indices for RIIO-GD2. They felt that Ofgem had defaulted to the RIIO-GD1 position on RPEs.
- 9.4. Regarding any future discussions, the group agreed that it would be constructive for participants to review the consultation responses beforehand. In response to a question on timing from one stakeholder, Ofgem explained that they intended to publish all non-confidential responses as soon as all permissions were in place.
- 9.5. In terms of consistency of treatment between RPEs and OE, one stakeholder queried whether OE should also be indexed. They noted that in theory, this may be a reasonable approach, but accepted that the availability of productivity indices may limit this in practice.
- 9.6. The stakeholder also queried the starting year for both RPEs and OE, and noted that there were inconsistencies in this area at DD, and they think that the wrong starting year had been used by Finance to set OE.
- 9.7. One stakeholder raised their view that the normalised cost split Ofgem use should take account of adjustments for London pay and productivity factors.

9.8. In response to a question from a stakeholder on the timing of next steps, Ofgem noted that they intend to hold a follow-up session with GDNs on RPEs and OE ahead of the FD publication.

## **10.AOB**

10.1. The group discussed future engagement, and it was agreed by all that instead of another CAWG, some more focused meetings on specific topics where needed would be most productive. OE and RPEs, and model assurance were suggested as topics for further discussion. A stakeholder suggested that there should be more discussion on the COVID-19 impact. Ofgem suggested that it would be most relevant to continue discussions on the COVID-19 in the same meeting as the OE and RPE discussions.