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Cost Assessment Working Group
Meeting 16

Ofgem, GD Cost Assessment Team
16/09/2020

OFG1161

Agenda

1. MOBs reporting
2. Model assurance
3. Use of latest RRPs data
4. Synthetic unit costs
5. Opex trade-offs with disallowed repex and capex
6. Disaggregation methodology
7. Non-controllable costs
   - Exit capacity update to reflect UNC678
   - Shrinkage
8. RPEs & OEs
9. Any other matters & next steps

1. MOBs reporting

GDN discussion

2. Model assurance

Modelling QA

- To maximise robustness and confidence in the modelling suite, we're keen to share updated modelling files for additional error checks ahead of Final Determinations
  - Review period: 17 Sept to 2 Oct, plus a week for additional comments
  - Starting from Support files (eg cost drivers and CSV) to ensure potential errors in input data are picked up early
  - Process files reviewed at a later stage

- **Do you agree with the proposed timeline? Any concerns**?
- Option for GDNs to review subset of models if more suitable

3. Use of latest RRPs data

Use of 2019/20 RIGs Data

- Consultation question 31: *Do you believe we should take into consideration revised cost information for the remainder of GD1 including 2019-20 (actuals) and 2020-21 (forecast)?*

- Summary of consultation responses
  - 3 GDNs in favour of using latest RIGs data (conditional); 1 GDN opposed.
  - *"Covid-19 means the 20/21 forecasts are likely to be unchanged materially from our BPDT forecasts because we cannot accurately predict the wide-ranging impacts."*
  - *"If we are including GD2 forecast data and historical GD1 data then there is no justification for excluding 2019/20 actuals or 2020/21 forecast cost data".*
  - *"Yes, as long as this is part of a general update and error correction process for the model data. Additionally, it would need to be part of a new consultation on the cost models in October 2020".*
  - *"Covid-19 impacts should not be [considered] as they could adversely affect accuracy of the models".*

- Materiality
  - 2019/20 actuals: latest RRP is (2.6%) <u>lower</u> than Dec BP, across all GDNs.
  - 2020/21 forecasts: latest RRP is 8.6% <u>higher</u> than Dec BP, across all GDNs.

- Considerations
  - How reliable is it to consider the updated 2021 forecast in isolation? (e.g. an increase in workload in 2021 could lead to a decrease in workload in 2022)
  - How have you excluded the impacts of Covid-19 in your latest RIGs submission?
  - Ofgem rely on the BPDT format, so GDNs would need to resubmit their BPDTs with this latest data.

- Timeline
  - BPDTs would need to be resubmitted by September 25th.

4. Synthetic unit costs

Repex synthetic unit costs

- Should we consider more aggregate measures for SUCs? If so, which categories? i.e.:
  - Remove material (DI/CI&SI) split in Tier 1, 2A, 2B and 3 mains?
  - Aggregate capitalised replacement with different category?
  - Tier 2A and Tier 2B together?
  - Could we integrate iron >30m with relevant Tier (based on closest comparable diameter bands)?

- Should we consider the use of GD2 data in calculating SUCs?

- Are there any other adjustments you think we should make to repex and/or capex SUCs?

5. Opex trade-offs with disallowed repex and capex

Disallowed repex/opex trade-off

- GDNs have noted that if repex is disallowed this may increase their opex as older mains/ services remain in place that require increased maintenance and repairs.
- We consider that the GD1 approach for correcting for workload adjustments is appropriate. This is set out below.

- Because we are using forecast expenditure, we also need to increase the forecast opex that is feeding into the totex model. We consider that the difference between the opex in the CBAs 'baseline' and the opex in the disallowed option is the appropriate uplift that should be applied to opex.

Questions

- Should we adopt the GD1 approach for adjusting opex workload?
- Should we uplift the opex by the difference between GDNs' forecast opex costs without undertaking repex and their forecast opex if they did undertaking the repex?

Disallowed capex/opex trade-off

- A similar issue occurs for capex.
- As we have disallowed a small number of capex projects, we are proposing to assess these on a case-by-case basis to determine if disallowing them would lead to higher opex.

GDN	Project	Major Project vs Asset Health	DD reason for disallowance
So	Battle PRS - System 2	Asset Health	Duplicate project
So	E&I Minor Works	Asset Health	Duplicate project
So	St. Mary Cray 1 - Boiler	Asset Health	Need case not made
So	St. Mary Cray 1 - CHP Unit	Asset Health	Need case not made
So	Westerham PRS - System 2	Asset Health	Duplicate project
Sc	Replace atmospheric vaporisers	Asset Health	Need case not made
Sc	E&I Minor Works (~15 sites)	Asset Health	Duplicate project
Sc	Georgetown PRS	Asset Health	Lack of evidence of poor condition
Lon	London Medium Pressure – capex component of repex	Asset Health	Included in reopener

6. Disaggregation methodology

Disaggregation methodology

- Should we consider separate scaling factors for regression and non-regression components of modelled costs?
- In disaggregating aggregate modelled costs, should we consider using the submitted proportions of costs?
- Any other comments on our proposed disaggregation approach?

7. Non-Controllable Costs

Updating Non-Controllable Costs for RIIO-2

- UNC0678
  - In May 2020, Ofgem approved UNC0678. It will take effect on 1st October 2020. Commodity charges will no longer apply, and postage stamp pricing will apply to all offtakes.
  - Should exit capacity pass through costs be updated for final determinations?

- Shrinkage
  - Should shrinkage pass through costs be updated for final determinations?

- Are there other non-controllable costs that may need updating for FD?

- Timing
  - Subject to the discussion on using latest RIGs data, updated non-controllable cost data would need to be resubmitted to Ofgem no later than 30th September.

8. RPEs and Ongoing Efficiency

Key issues raised in DD responses:

RPEs

- Index selection – Ofgem has not given sufficient consideration to alternative indices proposed by companies
- Costs used to determine materiality and weighting – Ofgem should use allowed rather than submitted costs
- Definition of materiality test – this is inconsistent with the materiality test used for UMs

Ongoing efficiency

- Treatment of embedded efficiency – Ofgem failed to adjust correctly
- Application – Incorrect compounding which leads to incorrect starting point for RIIO2
- Innovation challenge – Is inappropriate and represents double counting
- GO v VA – By selecting from the top of the range, Ofgem has put too much weight on VA, and not given appropriate weight to GO

- Impact of economic shocks – Ofgem has not considered the potential impact of Covid19 or Brexit in their DD position

We will review the evidence and any additional information provided

9. AOB and next steps

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