

RIGs Development Working Group – Meeting 2

From: Ofgem

Date: 4th November
2020

Time: 10:00 – 13:00

Location: Teleconference

1. Present

Ofgem
Cadent
NGN
SGN
WWU

2. Introduction & action points update

2.1. The WG (Working Group) discussed the action points from the previous WG meeting, which included:

- NARM's (Network Asset Risk Metric) team confirming that it plans to develop a separate NARM RRP (Regulatory Reporting Pack). The proposed NARM RRP will be closely aligned with the main GD2 RRP and the latter to include an interface output table to the NARM RRP.
- Ofgem's Regulatory Finance team propose to remove their Revenue RRP guidance from GD2 RIGs and set up a new guidance document to cover PCFM costs and revenue. It is also expected the new GD2 RRP will have an output sheet compatible with the RIIO-2 PCFM.

2.2. In response to the development of an independent NARMs RRP, GDNs confirmed their attendance at NARMs Working Group meetings and expressed concern about the volume of data requirements which will potentially outweighing expected benefits. Cadent's view is that NARMs reporting should be included in the RRP pack rather than as an independent set of reports.

2.3. Ofgem indicated at the appropriate time it will invite NARMs leads to the WG for discussions. GDNs urged Ofgem to bring forward the invitation as early as possible.

3. RRP model principles and overview

3.1. An overview of the model was presented, highlighting that the focus of the new model is to make it streamline and robust. It was confirmed that best practices from other Ofgem sectors have been incorporated e.g. inclusion of multiple years data from Electricity Distribution sector template.

3.2. The new model comprises of three sections i.e.

- Opening tabs (mechanics)
- Input sheets (containing single activity-based sheets, assets, and other data)
- Summary sheets (these incorporate the five costs categories consistent with Ofgem's Regulatory Finance requirements).

3.3. There was consensus that the new model is a pragmatic way forward and will be easy to develop tailored summary sheets. For example, streetworks costs which is currently reported under Opex will be able to be disaggregated into their Repex, Opex and Capex elements in the summary sheet.

3.4. There was general acknowledgement that the model is work in progress and GDNs are keen to review proposed new tabs such as Business Support and walkthrough practical examples such as asset inputs and level 2 cost categories which will be feeding into the summary sheets.

4. Treatment of overhead costs

4.1. Cadent presented on how it treats group level costs, closely associated indirects, and company and contractor overheads.

- 4.2. The key cost apportionment drivers for splitting group costs to individual networks include applying average Full Time Employees (FTEs), supply points, number of operational sites or costs shared equally.
- 4.3. SGN confirmed it has similar cost apportionment drivers but does not split group costs equally between networks without applying a driver. SGN noted that its apportionment methods are externally reviewed as part of the annual auditing process.
- 4.4. Cadent commented that its networks' 'efficiency gaps' implied by totex regression modelling may be partly due to cost apportionment policies rather than true cost inefficiencies. Cadent suggested that group companies consider using Modern Equivalent Asset Value (MEAV) for group cost apportionment in RIIO-GD2.
- 4.5. Some GDNs noted they currently do not know Ofgem's view on MEAV as an appropriate cost apportionment driver and need clarification before considering such a shift. **Action – SGN and Cadent to quantify, at a network level, the cost impact of using their current cost apportionment methods versus MEAV.**
- 4.6. For network overheads, i.e. the allocation of indirect opex costs to capex and repex, Cadent confirmed indirect costs are only transferred to capex/repex when they meet the criteria as set out in International Accounting Standards (IAS) 16 (Property, Plant and Equipment), otherwise the costs remain as opex. Other GDNs also confirm they follow the same standards but noted that there may be differences in interpretation.
- 4.7. For contractor overheads, Cadent noted that it has a mix of both open book (where contractor overheads are billed separately to direct costs) and closed book (where overheads are not invoiced separately but included with the direct cost of the services contracts). Other GDNs confirmed they all operated with closed book contracts, partly because they have not used large strategic contracting partners.
- 4.8. One GDN highlighted that treating contractor overheads becomes increasingly difficult when subcontractors are employed by principal contractors. They also considered

contractor overheads as being akin to direct costs for the GDN because they represent the cost of delivering a direct service.

- 4.9. The group discussed the notion that as well as needing to consider the allocation of group costs through to networks and totex categories (e.g. capex), it is also necessary to consider the allocation of any costs to non-regulated entities.

5. Closely Associated Indirects (CAI)

- 5.1. Cadent stated the rationale for introducing CAIs was to encourage better cross sector benchmarking but highlighted common CAI differences between the electricity sector i.e. distribution and transmission and discussed potential additional differences if adopted by GD.
- 5.2. There was a consensus that cross sector CAI benchmarking would not work effectively due to differences in the nature of CAIs between sectors, and a requirement for the GD sector to split out CAIs would only increase reporting challenges.
- 5.3. NGN suggested alternative measures of customer management and operational management costs to be allocated to repair, maintenance and emergency which would improve consistency. There were no objections raised to this proposed approach.
- Action – Ofgem to seek further clarification on the above proposal from NGN on how this will improve reporting and benchmarking.

6. Business Support Costs (BSC)

- 6.1. There were discussions on BSC reporting differences between GDNs, e.g. IT costs.
- Action – Ofgem to create a table to capture GDNs BSC reporting differences and share with GDNs to populate for future WG discussion.
- 6.2. The GDNs were in general agreement that the 8 groupings for BSCs in the BPDT were appropriate and encouraged its adoption into the new RRP model. It was

acknowledged that there are some reporting issues such as stores & logistics and contracted-out activity costs which need to be discussed in future sessions.

6.3. There was general agreement that BSCs would benefit from a refresh through an open discussion at a future working group on the nature of BSCs across companies.

Action – Ofgem to lead on the revision of BSC definitions, cost allocation and minimising BSC data input in future BPDTs (Business Plan Development Templates).

7. Reporting challenges

7.1. Key reporting challenges discussed include:

- Streetworks due to its degree of complexity.
- Unplanned interruptions – need to understand what GDNs are specifically required to report.
- Guaranteed Standards of Service (GSoS)
 - Clearer definition of the volumes to be recorded and associated payments.
 - Funding for London.
- Maintenance costs, particularly for non-routine maintenance, currently there is no defined criteria for opex and capex elements classification. There was a proposal to review the template to provide better classification and show both Opex and Capex elements.
- Minimising duplications between the new environmental report and GD annual report.

8. Totex categories

8.1. Ofgem proposed the current totex make up comprising of controllable opex, capex and repex be augmented to improve compatibility with Regulatory Finance and NARMS

reporting. Ofgem proposed to extend the totex make up to five categories i.e. Direct opex, Business support, Load capex, Other capex and Repex.

8.2. There was general agreement on the above proposed totex categories. It was noted that opex/capex/repex can be built up from these five extended categories.

9. AOB

9.1. There was general agreement that RIIO-GD2 RIGs (guidance) should be developed in parallel with the new RRP (tables), rather than focussing on guidance separately towards the end of the process.

9.2. Action - Ofgem to check with repex Lead on availability for WG3 and circulate proposed dates for the meeting.

9.3. Action - GDNs to access RRP Feedback Log posted on Huddle and complete with comments and recommendations to help with RRP development.