

CEG @ WPD	
Meeting name	WPD CEG
Date of meeting	N/A
Subject	Final report to CG July 2021
Outcome	<input type="checkbox"/> For decision <input checked="" type="checkbox"/> For approval <input type="checkbox"/> For noting <input type="checkbox"/> Other:
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Paper co-ordinated with:	All CEG members
Explain purpose / impact:	The CEG must produce a report to the CG for submission on 2 August 2021. This is the final document for CEG members' approval . CEG members are asked to approve the report by email no later than 2pm on Sunday 1 August 2021 . Lack of response will be considered approval.
Recommendation:	N/A
Minute:	Approved for sending to CG and WPD

CEG @ WPD - Report to Challenge Group

Foreword by Duncan McCombie, CEG @ WPD Chair – July 2021

Who we are

The CEG @ WPD¹ (“the CEG”) was set up in March 2019 to provide independent scrutiny of the business plan produced by Western Power Distribution (“WPD”) during the RIIO-ED2 regulatory price control process. The group is independent from both WPD and from Ofgem and is designed to offer robust challenge to WPD’s proposals, and to help the company’s bill-paying customers and stakeholders understand the extent to which its plans reflect and will meet the needs of customers today and in the future. We aim to ensure WPD’s proposals have been properly considered, well-justified, and represent good value for customers.

CEG members represent a cross-section of the energy industry and beyond, bringing individual expertise and experience across a broad range of energy and customer issues, including energy system transition, price controls, vulnerable customers, the environment and traditional and non-traditional business models.

Our approach

WPD has made significant progress in its approach to creating its business plan since the CEG was created over two years ago². We have seen the company evolve its process of capturing customer and stakeholder input to better influence its draft business plan and commitments.

This report is not focussed on the positive changes the CEG has already seen implemented by WPD in creating their draft business plan, nor do we describe the process we have followed as we have challenged WPD and scrutinised its proposals; instead, as requested by Ofgem and the Challenge Group (“CG”), we focus on the areas where we see WPD has more to do before it submits its final plan in December 2021.

We have developed our own criteria for what constitutes ‘well-justified’ and have applied these standards in our assessment of WPD’s plan. These criteria, set out in section 1 of this report, have been refined after sharing with the company, the CG and Ofgem. Other CEGs will have taken their own approach, and we note that this may mean different distribution network operators (“DNOs”) are assessed differently at this stage by their CEGs; we have not considered the plans of other companies, or the methodologies used by other CEGs.

How to read this report

WPD must submit its final business plan to the industry regulator, Ofgem at the end of this year. The company’s plan covers the period 2023 – 2028, and our report follows the same structure, and uses the same chapter numbering, as WPD’s plan to aid cross reference.

The CG asked several questions of CEGs. We have endeavoured to respond to these in our report, and signpost in annex 1 where in our report the relevant material can be found.

¹ [CEG @ WPD website](#)

² See [open letter 22 February 2021](#) and [open letter 24 May 2021](#) to demonstrate how we have publicly sought to influence WPD

Executive summary

Introduction

The CEG has provided robust scrutiny to WPD over the past two years as the company developed its business plan for RIIO-ED2. We have endeavoured to verify the plan is driven by customers and stakeholders and is ambitious, well-justified and delivers value for customers' money. WPD has been open to the CEG's challenges and made significant improvements to its draft proposals. Given the limited time until the company publishes its final plan later this year, this report focusses solely on those areas where we have outstanding concerns with the draft plan, particularly where it is not well-justified or sufficiently ambitious for the period it covers.

Our approach

We have sought to test WPD's draft plan against objective criteria to appraise whether it is well-justified, sufficiently comprehensive and ambitious. In our view, to be well-justified, the plan must:

- 1) include only actions appropriate for a DNO to undertake and that electricity distribution customers should fund;
- 2) consider alternative approaches to meet objectives and explain why the proposed approach is best;
- 3) demonstrate that the costs are efficient and that the benefits of the actions plausibly outweigh the costs (recognising benefits may not all be quantifiable and may be uncertain);
- 4) test whether a representative sample of customers, as well as stakeholders, support the business plan when properly informed of the costs and benefits;
- 5) propose how the initiatives included will be treated in the price control so that customers are not exposed to unacceptable risks (e.g. paying and not getting the benefits); and
- 6) be consistent with any assurance commissioned by WPD.

Outstanding concerns

- **The plan lacks full justification**

The CEG's assessment is that WPD's draft business plan has several good elements and articulates customers and stakeholders driving and supporting its priorities. There are also significant areas where the plan has not met the 'well-justified' criteria above and is therefore not fully justified.

The main CEG concern is that in elements of the plan the justification of why proposals represent best value for consumers is lacking. Options proposed are often incremental, and the CEG sees only modest proposed cost efficiency and performance improvements. Further, WPD has not demonstrated the options it considered for alternative ways to meet its objectives (criterion 2), how it arrived at the targets it presented to stakeholders, nor the assumptions it made about costs associated with these targets (criterion 3). For many of the proposals we have reviewed, alternative options are missing or discounted without thorough evaluation, explanation of the benefits for customers is missing and there is insufficient evidence provided to demonstrate that the benefits outweigh the costs. We continue to press the company to show us how it arrived at its targets.

WPD's plan includes significant increases in expenditure in several areas. While these may be appropriate, full justification is not included in the plan. This particularly applies to discretionary expenditure incurred to improve WPD's operations, where the benefits are not enumerated nor clearly

reflected as efficiencies elsewhere in the plan. In relation to asset health, we see inconsistent application of WPD's own analysis of required expenditure.

The CEG only recently saw WPD's Customer Value Proposition ("CVP") proposals. These include some plans that could deliver benefits for customers, but it is not clear that in all cases WPD is best placed to do the schemes, nor that its customers should fund them (criterion 1). Further work is needed, including improved identification of benefits and subsequent repeated acceptability testing with customers, to meet the high bar needed for Ofgem to award an incentive at customers' expense.

- **Customer and stakeholder engagement is extensive but incomplete**

WPD gives the output of its stakeholder engagement considerable weight when justifying its business plan proposals. There is no doubt its framework for engaging with customers and stakeholders is extensive, having been developed over many years, and that the engagement programme for RIIO-ED2 is a marked increase on ED1 (criterion 4). The CEG notes that engagement with key whole systems stakeholders such as major energy users and local authorities is not yet at the level of sophistication required given the scale of the change and pace required to achieve net zero and minimise costs. Further, lack of analysis of costs and benefits and of alternative proposals means it is not always clear stakeholders were presented with appropriate options or sufficient information to provide fully informed feedback or considered alternatives.

- **Impact on customer bills is unclear and financing assumptions do not match Ofgem's**

The CEG has been unable to verify WPD's statements on customer bills and bill trends. WPD stated throughout its stakeholder engagement and consumer research that bills would be 'broadly flat' before inflation; however, since customers in different licensed areas may see very different bill profiles (some rising, some falling), we feel acceptability of these bill impacts will need to be explicitly retested before the business plan is finalised. The CEG would appreciate additional guidance from Ofgem on quantification of bill changes to ensure a consistent approach is taken across DNOs.

WPD includes modest ongoing efficiency improvements based on all-DNO research which we have not assessed, and we have not seen evidence of explicit efficiencies derived from external benchmarking. The CEG notes WPD's proposed cost of capital is higher than Ofgem's assumptions.

- **Opportunities are missed regarding digitalisation and innovation**

WPD has a strong track record of developing and managing processes to deliver outputs, particularly those related to meeting regulatory requirements, and in delivering projects; it reacts quickly to demand and was one of the first DNOs to set up a flexibility platform and responded well to the Energy Data Task Force's requirements. The CEG expects, innovation and digitalisation are opportunities to fundamentally improve the way the business operates by embedding them in the company's culture and strategic approach, and the CEG has seen limited evidence that WPD is considering such solutions as alternative approaches to existing processes; many of its commitments simply build on current ways of working and do not meet criterion 2 above. As a result, the plan includes valuable innovation and digitalisation projects but falls short of genuinely integrating innovation and digitalisation across the business.

- **The plan relies on uncertainty mechanisms working effectively**

WPD's proposed investment in reinforcement is based on a forecast of EV chargers and heat pumps that is much lower than the Climate Change Committee's 'balanced pathway' to net zero. The plan proposes uncertainty mechanisms are used to unlock investment if there is more rapid deployment, but the CEG

has not seen sufficient detail to assess if they will work effectively, within the company and between company and regulator. If they do not, there is a significant risk WPD becomes a barrier to net zero, due to investment required not taking place in time to meet customer demand (criterion 5) and, whilst it is important WPD has sufficient funding to deliver net zero, stakeholders and customers must be given meaningful opportunities to work constructively with the company to minimise the costs of this transition.

- **Next steps**

The CEG will continue to press WPD to address the gaps we outline above, and scrutinise the outcomes, before submission of its final plan in December 2021, and will engage with Ofgem and the CG where this is helpful.

1. CEG's analytical approach to assessing WPD's business plan

1.1 The CEG's objective is set out in its terms of reference (as at September 2020):

"The CEG will provide independent scrutiny of, and challenge to, WPD's business planning and decision-making process for RIIO-ED2 reflecting the needs and preferences of existing and future consumers and promoting good value customer outcomes, with a focus on affordability and the protection of consumers in vulnerable circumstances, the environment, sustainability and the transition to a low carbon energy system."

1.2 We have sought to test WPD's business plan against objective criteria and hold the company to a high standard. In the context of the CEG's role in the price review process, we want to ascertain whether WPD's business plan is well-justified and sufficiently comprehensive and ambitious to address the challenges it faces.

1.3 We have reviewed Ofgem's guidance carefully and, whilst it asks various questions of CEGs, it does not provide a structured approach for them to follow. We have therefore developed and shared our own, and in our view to be well-justified, a DNO's business plan must:

- 1) include only actions appropriate for a DNO to undertake and that electricity distribution customers should fund;
- 2) consider alternative approaches to meet objectives and explain why the proposed approach is best;
- 3) demonstrate that the costs are efficient and that the benefits of the actions plausibly outweigh the costs (recognising that benefits may not all be quantifiable and may be uncertain);
- 4) test whether a representative sample of customers, as well as stakeholders, support the business plan when properly informed of the costs and benefits;
- 5) propose how the initiatives included will be treated in the price control so that customers are not exposed to unacceptable risks (e.g., paying and not getting the benefits);
- 6) be consistent with any assurance commissioned by WPD.

1.4 We have adopted these criteria to ensure we have taken a consistent approach across the different areas of the business plan and to be clear on the reasons for any concerns we raise. However, even if we consider what is included in the business plan to be well-justified against these criteria, it may not be sufficiently ambitious to deliver all that is required from the DNO (for example, to help deliver net zero). This therefore needs to be assessed separately as a sufficiency check.

1.5 It is important to note that any assessment we make of WPD's business plan against these criteria does not imply any relative evaluation against the business plans of other DNOs, which we have not assessed.

2. CEG's assessment of 'We keep our promises'

Overall assessment

- 2.1 We have scrutinised the information available to us, which is primarily information provided by WPD and as noted above, does not include independent benchmarking or comparison with other DNOs.
- 2.2 Specifically, we note several areas in which WPD has performed well:
- WPD has delivered strong performance in the current price control period, particularly in meeting the output commitments made at the outset on customer service and reliability;
 - the company's performance is underpinned by a strong focus on safety and customer service, and it clearly takes these issues seriously;
 - WPD has developed strong capabilities in reacting to emerging challenges, including the increased solar penetration early in ED1, data and DSO planning;
 - WPD has been rewarded where it has performed well through regulatory incentives. Its outperformance on rate of return has been largely driven by outperformance on output delivery incentives, with the financial benefits of being fast-tracked offset by financial disadvantages on the allowed debt costs.
- 2.3 We note that WPD will be under new ownership soon, which may change its priorities, although we have been told this is not expected to be the case.
- 2.4 However, there are areas where the CEG believes there to be room for WPD to improve. In particular, we see less evidence of:
- cost efficiency improvements (we see modest totex underspend, with cost savings largely offset by new costs, meaning WPD's efficiency gains tend to result in better performance rather than lower costs to customers);
 - WPD developing proactive approaches to get ahead of emerging challenges. We noted above that WPD has been effective in reacting once the challenges it faces become reasonably clear, but that the company is less successful in taking pre-emptive actions where there is greater uncertainty of outcome.
- 2.5 WPD's commitment to delivery and to customer service, along with its track record in responding well to emerging challenges, gives us confidence that the company will be capable of delivering on its commitments for ED2. However, we consider that a more proactive approach could sometimes lead to better, or more efficient outcomes - although we recognise that a reactive approach done well maybe be better than a proactive approach done poorly.
- 2.6 An example is digitalisation, where WPD has responded positively to the findings of the Energy Data Task Force³ and acted on the data recommendations. We have been unable to confirm a proactive and leading approach to exploring the opportunities digitalisation provides WPD to work in different ways or improve efficiency, at least until Covid-19 restrictions meant it had no choice.

³ [Energy Data Taskforce: A Strategy for a Modern Digitalised Energy System \(catapult.org.uk\)](https://catapult.org.uk/energy-data-taskforce/)

3. CEG's assessment of 'Giving customers a stronger voice'

Overall assessment

- 3.1 The CEG notes the programme of engagement undertaken by WPD for ED2 is a marked increase on that undertaken for ED1, both in terms of the quantity of stakeholders and customers engaged, and in the breadth of coverage (criterion 4).
- 3.2 Whilst WPD's process for engagement was extensive, it is not clear stakeholders were always presented with appropriate options or given sufficient information on potential alternatives to provide meaningful feedback. We also note WPD's claim bills will remain 'broadly flat' may need to be retested, particularly where there are differences between licensed areas.
- 3.3 Further, the CEG notes that given the pace of actions and scale of the challenge required by net zero, WPD's ongoing engagement with key whole systems stakeholders, such as major energy users and local authorities, needs to develop into ongoing strategic relationships.
- 3.4 WPD adapted well to the impact of Covid-19 on its proposed engagement programme, with the revised approach to key elements, such as stakeholder workshops, actually being shown to benefit the programme through demonstrably higher levels of attendance online than had previously been achieved in face-to-face events.

Inclusivity

- 3.5 We have observed an inclusive approach to sampling and recruitment, with WPD seeking feedback from a wide range of stakeholders and bill paying customers, including ensuring that the views of future bill payers and the vulnerable were represented. We will, however, be looking for greater testing of the acceptability of likely bill increases on future customers prior to publication of WPD's final business plan. Coverage has been expanded to include new players and innovators in areas such as net zero and digitalisation, and the company has recognised the diversity and significance of key whole systems actors, particularly local authorities and major energy users in the context of the net zero transition, and the need for a different engagement methodology to ensure these relationships help support value for money outcomes for customers (including beyond the business planning process). Detail remains lacking in the CVPs (see from 4.22) and in linkages to the operation of the mechanisms (such as uncertainty mechanisms) which will turn such engagement into value for money outcomes for customers.
- 3.6 Ongoing day to day engagement undertaken as business as usual is further helping to inform WPD's research and the company's commitments. We would like to see this more clearly evidenced in WPD's engagement programme in the final business plan.

Approach to engagement and CEG scrutiny

- 3.7 The majority of WPD's customer research and stakeholder engagement has been qualitative in nature to support the company's 'blank sheet of paper' and co-creation approaches. At all stages, the CEG has been given sight of the research development process and materials, as well as of the event reports and feedback, to allow for scrutiny and challenge. This evidence, and the changes WPD has made as a result of our feedback, has given us confidence in the process, and that the priorities driving WPD's business plan commitments have been derived from customer and stakeholder feedback, rather than WPD having 'chosen' only what they wanted to hear.

- 3.8 Robust quantitative research studies with bill paying customers have also been used to help determine social values and business plan acceptability. Since WPD has stated throughout its stakeholder engagement and consumer research that bills would be “broadly flat” net of inflation, we need clarification this will be true, and as customers in different licensed areas will see very different bill profiles, acceptability of these will need to be tested.
- 3.9 The CEG has evidenced a robust process for conflict management and weighting where required.

Enduring engagement

- 3.10 WPD has detailed how it will continue to engage with stakeholders throughout ED2 and how it will draw on the learnings from ED2, including because of Covid-19, in defining future engagement programmes. The company intends to begin routinely surveying its customers views of, and satisfaction with, WPD compared with other non-energy service providers during ED2, but only those customers it has contact with.
- 3.11 As noted above, the CEG is not convinced that ongoing engagement with key whole systems stakeholders will be at the strategic level required to deliver optimal outcomes on the journey to net zero. While WPD has recognised the need for this and the distinct nature of the challenge, the cultural and organisational challenges it faces are significant and are not yet reflected in its plan.

4. CEG’s assessment of ‘Our commitments’

Overall assessment

- 4.1 The CEG believes that WPD has carried out an extensive engagement process but not yet fully justified the commitments and outputs in its business plan.
- 4.2 As section 3 of our report above shows, WPD has engaged widely and thoroughly with consumers and stakeholders, which has enabled it to identify the priorities for its business plan. As part of its testing two draft plans with stakeholders, the company has also increased the ambition of 35 of its targets. However, WPD has not yet demonstrated to the CEG that it has fully considered alternative ways to meet all its objectives, how it arrived at the business plan targets it presented to stakeholders, evaluation of benefits, nor the assumptions it made about the costs associated with these targets. The feedback from stakeholders was predicated on the targets and costs presented by WPD, so it is important for WPD to show all its targets were appropriately stretching.
- 4.3 WPD’s justification relies heavily on bill-paying customers and other stakeholders to justify decision making. The CEG has yet to see robust and objective justification of commitments or expenditure. Justifications need to build on stakeholder acceptance, and include cost benefit analysis, consideration of other options (including those rejected), valuation of benefits, and justification of costs.
- 4.4 In its final business plan, WPD needs to demonstrate a clear rationale for its targets, showing that they are appropriately ambitious.
- 4.5 For each of the targets in its business plan the CEG would expect the company to show what options were considered for these targets and why the target proposed was chosen. We would expect the company to address the ‘well-justified’ criteria in section 1 above. In addition, since

WPD states in its plan that it is committed to being an industry leading DNO, and that is what its stakeholders want, the CEG would expect to see targets selected that will ensure leading future performance against industry comparators and other relevant benchmarks in those areas that stakeholders viewed to be high priority.

Examples of specific commitments and outputs that need further justification by WPD

Meeting the needs of consumers

4.6 WPD has partly justified its commitments related to meeting the needs of customers.

Customer satisfaction

4.7 WPD has support from customers about the level of its proposed targets for customer satisfaction. The CEG has not seen cost benefit analysis of these targets, what range of options the company considered to test with stakeholders in its earlier draft plans, nor demonstration of efficiency.

4.8 Stakeholders told WPD that maintaining industry leadership in these respects is important. WPD has proposed improvements in network reliability for its worst served customers and in its connections business. By not pursuing further improvements in customer satisfaction, WPD appears to have taken no account of the plans by, or performance improvements of, other DNOs in terms of customer satisfaction. WPD does not survey its customers' perception of WPD performance relative to customers' other service providers beyond energy, so is not able to use this data to justify its proposals for targets. The company's reference to comparison of its performance in Ofgem's customer satisfaction measure with the very different weighted basket of measures in the Institute of Customer Service's UK Customer Satisfaction Index⁴ can give only an approximate comparison against non-energy benchmarks which does not provide a robust justification.

4.9 WPD emphasises in its draft plan that it wants to maintain industry leading performance, backed by views from its stakeholders. However, WPD's customer satisfaction target is set only at the company's current level of performance, while some other DNOs have either already caught WPD or have proposed in their plan to overtake WPD's business plan target.

Vulnerability strategy

4.10 In its vulnerability strategy, WPD has shown it has fully met or exceeded all Ofgem's principles and baselines. The company proposes some new initiatives in this area.

4.11 The CEG has pressed the company to demonstrate from data, referred to in its business plan, how it will target its initiatives effectively and how far its plan will address consumers who may be entitled to help but are not currently getting it. This should help it address newly or temporarily vulnerable customers from Covid-19 and other reasons, and to help customers who could be left behind by the switch to net zero.

Maintaining a safe and resilient network

4.12 WPD makes some good proposals to maintaining a safe and resilient network in its plan and shows support of its customers for many of its initiatives. It has not demonstrated to the CEG that it has done full options appraisals for its proposed approach, which are needed to show it is fully justified.

⁴ [UK Customer Satisfaction Index \(UKCSI\) * Institute of Customer Service](#)

Further, whilst the CEG has been impressed with WPD's ability to explain its proposed approaches well in meetings, it is disappointing to see that these explanations do not always come across effectively in the draft business plan.

- 4.13 Examples where stakeholders agree the area is a priority, but we have yet to see analysis of alternative options with consideration of benefits include: school playing field safety, flood defences, worst-served customers, safety information, and community energy.
- 4.14 Other examples where justification is needed include the use of LiDAR⁵ (we have a formal CEG challenge outstanding in this area) and substation monitoring/smart meters which we have discussed but miss any evaluation of benefits which appear to be omitted from reinforcement proposals.
- 4.15 The CEG has recently seen a large number of the company's engineering justification papers ("EJPs") which provide further detail. These lack options for differing levels of performance and frequently compare 'do nothing' only with the selected approach. In the papers we have reviewed, where alternative options are identified, they are commonly dismissed without evaluation as not meeting very specific objectives which have not themselves been properly justified. Further, we would expect to see evidence of WPD routinely considering the whole system impacts of its proposals (at least gas, but ideally water, waste, telecoms etc. as well), and embedding whole systems thinking into its corporate decision making, processes and culture. A reactive, one-off approach (e.g., single innovation project) is not sufficient.
- 4.16 The clarity of several of WPD's commitments has improved since earlier versions of the plan. This improvement follows CEG feedback that they were too vague to be assessed or to see what the benefits would be. We are concerned that some commitments are still not measurable outcomes.
- 4.17 We note there are areas which were mentioned by stakeholders, but which are not addressed in the plan, such as in relation to short interruptions and tree replacement (i.e., planting trees to replace any removed). Omitting them may be the right outcome, but it is not obvious without justification for their exclusion being given.

Workforce resilience

- 4.18 The CEG considers WPD has not been sufficiently ambitious in its commitment to improve diversity levels in its workforce, which may result in it being unable to attract people with appropriate skills with regard to net zero, digitalisation and the other challenges it faces.
- 4.19 Specifically, a 1% improvement in diversity from WPD's current 85% men:15% women split is not at all ambitious when compared to benchmarks inside and beyond the sector, and WPD does not yet propose any diversity commitments at all beyond gender balance.

Connections

- 4.20 Despite considerable investment in digitalisation, WPD's commitments on connections are largely incremental. Whilst WPD commits to same-day response for domestic customers, improvement for other customers is targeted at just 1%, and does not appear to reflect the impact of the digitalisation investment WPD plans. Whilst stakeholder acceptance is high, alternatives offered to

⁵ Light detection and ranging technology used to aid airborne inspection of equipment and vegetation

stakeholders were a range of incremental options on timing and customer satisfaction, rather than innovative step-change solutions.

Flexibility

- 4.21 WPD's commitment 34, on the development of flexibility markets, is not well-justified against our criteria and lacks ambition. WPD will monitor customer satisfaction with its flexibility tender process but unlike other areas (connections, customer services) it does not propose a standard of customer satisfaction to measure against or any kind of financial consequence for failing to meet the commitment. As such, the commitment risks having a limited impact.

Customer value propositions

Overall assessment

- 4.22 The CEG has only recently received WPD's CVP proposals from the company, so has not yet fully scrutinised them. Based on an initial view, the CEG has several questions about each of the proposals that it will seek to answer before deciding whether or not to support one or more of them. The nature of the questions differs according to the CVP proposal, but a number relate to the untriangulated use of willingness to pay as a justification of value, which is outlined further in paragraph 4.33. The CEG is not yet satisfied WPD's CVP proposals achieves the high bar needed for Ofgem to award an incentive at the customer's expense.

Initial CEG questions about WPD's CVPs

CVP-1: Ensure WPD is a net zero business by 2028

- 4.23 This proposal goes beyond business as usual and received support from WPD stakeholders during the development of the business plan, and WPD being net zero by 2028 clearly has important benefits beyond the direct carbon savings that will be achieved. However, the plan does not detail these benefits, and although there will be some cost savings for WPD, many of the benefits are necessarily derived from assumed savings in carbon cost and result in a significant cost to customers which is not well-justified in the plan. Since bill payers will pay more for this proposal, further scrutiny will be required and clear carbon savings must be demonstrated.

CVP-2: Proactively partner with every local authority to help them develop ambitious local area energy plans

- 4.24 The CEG fully agrees with the importance of WPD working with local authorities on the journey to net zero as part of business as usual. The company needs to be clearer on how this CVP goes beyond business as usual and the benefits that justify its customers paying higher bills as a result of a reward to the company for the scheme.

CVP-3: Establish community energy engineers to support community-based energy schemes

- 4.25 The CEG welcomes the fact a major part of WPD's business plan is focused on ensuring the demand for low carbon solutions is facilitated and delivered in a timely way. The gap that the company and others have identified around community energy may well exist and WPD, as a DNO, undoubtedly has a part to play in helping community energy plans come to fruition. A clearer cost benefit is needed to show the proposal goes beyond business as usual and that the company should seek additional revenue from its customers to set up a team to do this.

CVP-4: Create a national energy plan for Wales

4.26 In its proposal, WPD points out that the Welsh Government's plans for energy in Wales could have significant impacts on its network. The CEG recognises that WPD providing input, with other key energy players in Wales, to the thinking about this change could have significant benefit to WPD and its customers. It is not yet clear that the proposal is:

- to address a gap in WPD's links with Welsh government that it should resolve as part of its existing baseline business; or
- genuinely a step change and a value creating new initiative that WPD customers should pay more for, and if it is, why this approach should be limited only to Wales.

CVP-5: Fund solar PV on schools and community buildings in areas of high economic deprivation

4.27 The CEG welcomes WPD focusing on helping deprived areas and notes the company received strong support during its stakeholder and customer engagement for helping vulnerable customers. This does not necessarily justify use of electricity customers' money to fund community assets, and strong specific customer support is needed to demonstrate customer value. In addition, the company needs to be clearer on the costs and benefits of this proposal to WPD's customers, what other options it considered and why WPD would be best placed to deliver it.

CVP-6: Offer 1.2 million Priority Services Register customers a bespoke smart energy action plan every two years

4.28 This proposal would help some vulnerable customers benefit from the transition to smart energy. The key question though is whether WPD is best placed to target customers who need help and whether other parties are better positioned to do this as part of their links and communications with vulnerable customers.

CVP-7: Deliver an annual £1m community matters fund, funded by shareholders

4.29 The CEG applauds WPD for its proposal to provide shareholder support for the community, but questions whether it is appropriate for a CVP reward at customers' expense.

4.30 Shareholder support for the community is a key strand of the company's social contract work and WPD will presumably seek reputational benefit from it as evidence of its corporate social responsibility. It is therefore not clear why customers should pay more for this initiative via a CVP reward, and WPD has noted its stakeholders expressed reservations about whether it was appropriate that customers' money should be used for activities of this kind.

CVP-8: Create an LCT energy advisory service for consumers to provide a support service for people looking to switch to electric vehicles, heat pumps and solar PV

4.31 The CEG welcomes WPD's engagement in proposals to support the vital and challenging transition to an increased rate of adoption of low carbon technologies. The justification for this proposal is unclear in terms of the cost benefit. Other questions relate to whether WPD is best placed to target customers with outbound marketing in order to make customers, who are seeking help, aware at the right time that WPD provides this service.

CEG's view of the robustness of the model used to justify CVPs

- 4.32 Until the CEG has seen final versions of WPD's CVPs, we are not clear how far the company has relied on the joint work with other DNOs on social value and the use of willingness to pay as the basis of its valuations. WPD does refer to values from its willingness to pay work, identified during research carried out for its business plan. The CEG considers that while willingness to pay is a useful component when triangulated with other sources of feedback and research, its use as a single valuation tool of social value has limitations unless it is supported by other data. In addition, we expect to see consideration of alternative options and clearer demonstration of benefits to customers. There is also currently no evidence of the use of benchmarks to support WPD's CVP proposals.

5. CEG's assessment of 'Delivering a smart and flexible electricity network'

Overall assessment

- 5.1 WPD's business plan demonstrates a strong, cross-company commitment towards meeting net zero carbon. In particular, we welcome the addition of commitment 36, supporting the net zero ambitions of stakeholders in each region, but note the all-important delivery and funding of this commitment relies on uncertainty mechanisms which are still being developed.
- 5.2 By contrast, the plan's approach to innovation and digitalisation is characterised by tactical actions, primarily focused on delivering innovation projects and focusing on data and DSO rather than a holistic companywide strategy that improves network operation or delivers new services for customers. There is limited evidence of systematic consideration of digitalised and innovative solutions or investment in innovation and digitalisation being integrated into end-to-end process change and service design, or of the potential step-change benefits to customers being realised. As such, it is a plan of valuable projects but not a strategy to effectively integrate innovation into business as usual or realise the efficiencies from innovation or digitalisation across the whole business and, therefore, lacks evidence that it represents value for money.

Outstanding concerns

Net zero

- 5.3 The CEG notes the cost information against which WPD's commitments to deliver net zero and support community energy initiatives is evaluated and embedded in uncertainty mechanisms, and the way in which such mechanisms will work remains to be fully defined.
- 5.4 WPD's processes for engaging with stakeholders and exploring alternative investment options with relevant third parties appear efficient for specific projects or connections. The CEG is concerned the business plan assumes the same or similar processes will also be efficient in identifying and responding to strategic 'trigger points' (e.g., between alternative pathways to net zero locally). The CEG recognises much progress has been made by WPD in engaging with local authorities (see section 3), but we are not fully convinced that WPD has explained how this will deliver optimal value for customers and are concerned that too much detail is still missing and/or limited to developing CVPs.

- 5.5 We are still awaiting a robust justification for proposals supporting community energy (see also comments on CVP-3).

Innovation and digitalisation

- 5.6 The lack of strategy to effectively integrate into the business is reflected in the following aspects of the plan.
- 5.7 The CEG cannot see WPD's ambition for digital transformation reflected in the tone or options appraised within the EJPs; indeed, WPD states its approach is 'evolution, not revolution'⁶. Either marked changes are not considered within EJPs, or where they are flagged, these changes are typically quickly discounted rather than having their cost-benefit rigorously appraised (e.g., EJP 074 Smart Meters, 089 Historian Analysis, 070 LV Monitoring, 073 Open LV). Consequently, WPD's digitalisation ambition is unclear and, further, its plan fails to fully meet criterion 2, as step-change digital alternatives are not systematically appraised in framing the ambition of its commitments and proposed expenditure.
- 5.8 The CEG observes there is no reference to digitalisation or innovation within the business plan principles. Where digital investments are alluded to, this is framed as 'IT' rather than 'digitalisation': chapter 6 adopts a new cost category of IT, signalling a focus on tool development, rather than digitalisation of a business model. Similarly, the Information Resources Applications team is seen to lead on tasks such as planning, project management, business requirements gathering, rather than WPD's strategy being implemented by managers within the business (EJP 178 Section 2). While the innovation strategy recognises the importance of culture and introduces performance metrics to reward teams that adopt innovative solutions, unless the barriers are understood and addressed, the mainstream adoption of innovation within the business is likely to remain at risk.
- 5.9 There is a mismatch between WPD's bold digitalisation project activity, and the ambition of some of its commitments (e.g., 1% improvement in commitment 12). WPD's incremental commitments on non-domestic connections have been broadly well-received by stakeholders. The CEG suspects there may be opportunities for the company to apply its digitalisation projects to meet customer needs more fully, and WPD partially acknowledges this, through signalling investments in an Integrated Network Model, Common Information Model, System Voltage Optimisation and more, enabling WPD to build a digital twin of its network. This is promising, yet there appears to be a mismatch between WPD's bold digitalisation project activity, and the ambition of its commitments to 2028. For instance, what might a co-created offer look like, whereby users interact directly with the digital twin to optimise their offer? How might their journey be reimaged off the back of WPD's digitalisation investments? A further example is EJP 091 on machine learning, which proposes a pilot by 2025, yet does not quantify customer benefits. In summary, whilst digitalisation costs are clearly quantified, it is not evident that customers will reap the full benefits of this investment through the results being embedded within WPD's core business.
- 5.10 The innovation and digitalisation commitments in the plan do not meet fully the well-justified criteria set out above. In particular, the plan lacks evidence of criterion 2 regarding credible alternatives and criterion 3 regarding demonstration of benefits outweighing the costs. Furthermore, WPD relies on its ongoing efficiency assumption as evidence of the impact of

⁶ EJP 178, IT applications

encompassing innovation into standard business practice. Also, lacking is criterion 1, justification for why WPD is best placed to create a low carbon technology service, which is both a commitment and CVP 8.

6. CEG's assessment of 'Expenditure'

Overall assessment

- 6.1 WPD proposes annual expenditure of £1,238m in ED2, a 19% increase compared to £1,043m in ED1. This excludes reinforcement costs above a base level – i.e., WPD's best view is expenditure will be higher. The CEG has focussed on the largest categories of costs and on general trends.

Outstanding concerns

- 6.2 On reinforcement costs, WPD has structured its approach very clearly with a base and best view, and £473M of costs identified as subject to the operation of uncertainty mechanisms. We understand WPD is not proposing any anticipatory expenditure. We are concerned that the detailed operation of these uncertainty mechanisms is not yet clear, and thus may not deliver optimal value for money for customers. Greater clarity is required on how uncertainty mechanisms will be driven by trigger points and governance mechanisms which are sufficiently sensitive to local conditions and the activities of other key actors in the whole energy system (see section 7).
- 6.3 On non-load related network investment, we note that despite a 12% increase in costs, asset risk is expected to worsen by 3%. On asset replacement, WPD proposes to decide on volumes and priorities based on asset condition rather than asset risk. This appears to conflict with its support for Ofgem's Network Asset Risk Metric approach which assesses whether the benefits to customers of replacement outweigh the costs, taking account of asset risk, which includes asset condition and criticality (i.e., the consequences of failure). WPD places more weight on the views of local managers which tend to coincide with continuation of existing run rates of investment than on its own modelling, resulting in targets different from what the model would indicate (for example, on transformer and HV pole replacement⁷). We recognise that the modelling should be a guide rather than necessarily determinative and that local insights may add more value but have not seen a clear explanation why WPD diverges from investments where customer benefits outweigh costs. While WPD's proposals significantly reduce network risk compared to the level it would otherwise grow to without investment, greater reduction for the same cost would be possible (according to the model) with a different approach.
- 6.4 Beyond the core asset replacement expenditure, the CEG has challenged WPD to provide justification for additional investments relating to overhead line safety, worst served customers, flood defences and a change of approach to tree trimming. We have recently seen EJPs covering some of these but not all. Those EJPs provide alternative options and describe benefits, but do not assess whether the benefits of the expenditure outweigh the costs nor provide sufficient evaluation of alternatives. We expect that some of these investments will be beneficial, but others may not, once work is completed on options, benefits and alternative solutions.
- 6.5 On IT and telecoms, substantial increases in expenditure are proposed (133% increase). We understand that there are several reasons, including increased monitoring, digitalisation,

⁷ EJP 058

modernisation and cyber-security (the latter being outside the CEG's remit). In the areas we have considered, we find written justifications lack consideration of alternative approaches or identification of benefits, so the cost-benefit cases are consequently weak. For example, we cannot ascertain whether, and if so how, the benefits of enhanced monitoring have been captured in lower reinforcement costs.

- 6.6 In terms of other cost areas, ED2 expenditure proposals are broadly flat against ED1 before consideration of efficiency or real price effects ("RPEs"). The CEG notes that WPD relies on an all-DNO study by NERA⁸ for its assumptions on ongoing efficiency and RPEs; given the all-DNO nature of this study, we have not sought to critique it. We asked WPD about the company's relative efficiency and how it might compare beyond the DNO sector, but WPD has not yet provided such analysis nor sought to justify its assumptions to the CEG, other than by reference to the NERA study that we have not reviewed. We therefore cannot support WPD's efficiency or RPE assumptions and recommend these are assessed by the CG on a cross-DNO basis.
- 6.7 We note WPD has not made any claims for company-specific cost factors to be used in benchmarking analysis, so the CEG has had no claims to comment on. We note some cost categories are higher in some of WPD's licensed areas than others (e.g., worst served customers in south Wales).

7. CEG's assessment of 'Managing uncertainty'

Overall assessment

- 7.1 The energy system is going through a period of unprecedented change. We note that more clarification is needed from Ofgem in this area but remain concerned that if WPD is not sufficiently ambitious, and proactive in quickly identifying and engaging with emerging signs of changing conditions locally and nationally, solutions may be slower, and less efficiently delivered than could be the case.

Outstanding concerns

- 7.2 During this price control period, the government's net zero policy decisions mean that WPD can expect to have to respond to rapid increases in the numbers of customers installing electric vehicle charging and heat pumps. WPD is proposing ex-ante funding for network reinforcement (including flexibility) based on a base case rate of installation of the low carbon technologies and uncertainty mechanisms to enable further funding if the rate of deployment of low carbon technologies means that more reinforcement is required.
- 7.3 The design and management of uncertainty mechanisms in the price control is, therefore, critical to enabling customers to install low carbon technologies in line with national and local net zero targets, but these mechanisms must be designed with care to ensure customers' money is used appropriately. The CEG notes that using uncertainty mechanisms rather than ex-ante funding for reinforcement may worsen the risk that WPD (or indeed any DNO adopting a similar, reactive approach) will be a significant barrier to net zero due to investment required not taking place in time to meet customer demand, particularly if obligations are not sufficiently clear. Further, it also means that the points Kwasi Kwarteng (Secretary of State for Business, Energy and Industrial

⁸ [NERA Economic Consulting](#)

Strategy) raised to Jonathan Brearley (Chief Executive Officer, Ofgem) in October 2020⁹, specifically about ED2 and what BEIS needs Ofgem to consider, to ‘touch the network once’ on the route to 2050 will not be followed and that less efficient approaches to network reinforcement are taken than could be achieved by planning for higher volumes of low carbon technologies.

- 7.4 In order to judge whether WPD has justified an efficient approach to meeting customer needs using uncertainty mechanisms, the CEG will need to see details of the mechanisms and how they will operate.
- 7.5 The CEG welcomes WPD’s confirmation in meetings that it is planning to deliver reinforcement and improved network management in line with its ‘best view’ and is ready to adapt rapidly to scenarios that see faster deployment of low carbon technologies. We would expect to see those commitments to customers clearly set out in the business plan, with an appropriate consideration of alternative options and a robust assessment of the costs and benefits of each.
- 7.6 The business plan sets out a largely reactive approach to responding to accelerated deployment beyond WPD’s ‘best view’. WPD has not clearly justified this approach against an alternative strategy to develop its ‘early warning system’ which would enable it to identify early signs of greatly accelerated deployment (from national policy development or local initiative-taking – or both) and plan its response more effectively. Without this ‘early warning system’, there is a risk that WPD will fail to anticipate these needs and must resort to approaches to meeting increased need for reinforcement which may prove more costly and less efficient.
- 7.7 The CEG considers WPD (and indeed Ofgem) should be clear with customers that bill impact calculated based on the proposed ex-ante funding for reinforcement would not enable the network to meet customer needs in two of the four National Grid Future Energy Scenarios¹⁰.

8. CEG’s assessment of ‘Competition’

- 8.1 The CEG notes that WPD’s stated support for competition is focused on the areas in which DNOs are required by regulation to facilitate competition; otherwise, WPD’s business plan states a preference for insourcing. WPD has provided verbal justification of its preference for insourcing; however, this is not yet adequately justified within the business plan or accompanying material
- 8.2 Justification for insourcing is particularly weak for non-core and newer business areas, where it is not apparent that WPD has adequately explored third party alternatives. An example is EJP011 on incorporating solar PV and battery storage on non-operational sites.

9. CEG’s assessment of ‘Financing our plan’

Overall assessment

- 9.1 The CEG believes WPD has not fully justified its approach to customers’ bills and bill trends within its draft business plan

Outstanding concerns

⁹ [Letter from BEIS to Ofgem October 2020](#)

¹⁰ [Future Energy Scenarios | National Grid ESO](#)

- 9.2 WPD was not clear about its specific bill proposals before it finalised its draft business plan and has developed its plan stating that customers' bills would be broadly flat. The CEG is still exploring with the company that the business plan is consistent with this claim and is seeking help from Ofgem on a consistent approach across DNOs to the quantification of bill changes. The CEG is also exploring with the company how bills will vary across WPD's different licence areas. We note that WPD is proposing a higher cost of capital than Ofgem's current assumptions, which adds to customers' bills.
- 9.3 As we note in section 6, it is also not clear at this stage that WPD is proposing an industry leading efficiency target during ED2. The CEG needs to see more justification for the company's proposals on overall efficiency.
- 9.4 Due to the uncertainties which remain around some of the financing components and the impact that could have on bills, we would expect the company to re-test acceptability if bills were to vary significantly either across WPD as a whole or by licence area. The CEG believes that any testing of and communication about business plans should be clear and avoid misleading stakeholders and customers.

Annex 1 – Signposting to responses to CG questions

CG 1. Justification of the plan by reference to the results of customer research and stakeholder engagement, and a clear approach to the trade-offs

We provide detailed comment on WPD's extensive customer research and stakeholder engagement in section 3 of this report, with our overall assessment set out in paragraphs 3.1 to 3.4.

WPD's conflict management process is robust, as noted in paragraph 3.10.

We discuss willingness to pay research in sections 4.22 and 4.33, specifically with regard to our concerns on its use as a justification of value when assessing WPD's CVP proposals.

We note in paragraphs 3.2, 3.5, 3.8 and 9.4 that WPD's conclusions from its engagement programme may need to be retested in some areas and note in paragraph 6.2 WPD is not proposing anticipatory investment.

CG 2. Strategies and proposals set out for: DSO activities; whole systems; consumers in vulnerable circumstances; and environmental action plans

We note in paragraph 2.2 that WPD has developed strong capabilities in reacting to emerging challenges, including DSO planning. Its approach tends to be tactical, and a companywide strategy to improve network operation or deliver new services to customers is lacking, as we discuss in paragraph 5.2.

WPD's engagement programme has been expanded to cover whole systems actors, as we discuss in paragraphs 3.3 and 3.7, but is not yet at a sufficiently strategic level (paragraph 3.12). We do not see evidence of the company routinely considering whole systems thinking, digitalisation or innovation in its decision making (paragraph 4.15).

Vulnerable customers were represented in WPD's engagement programme (paragraph 3.5). We discuss WPD's vulnerability strategy in paragraphs 4.10 and 4.11 and note that it has met or exceeded Ofgem's baseline standards.

The cultural and organisational challenges facing WPD meeting net zero are significant (see paragraphs 3.3, 3.11, 4.8, 5.1 and 5.3). We discuss the company's reliance on as yet undefined uncertainty mechanisms working well in section 7.

CG 3. Consumer value propositions

The CEG only recently received WPD's CVP proposals but our initial view, set out in sections 4.22 to 4.33, is that they do not yet achieve the standard needed for Ofgem to award customer-funded incentive.

CG 4. Cost benefit analysis approach

We discuss WPD's approach to cost benefit analysis at length in sections 4 to 7 of this report. WPD has not yet met the 'well-justified criteria we set out in paragraph 1.3.

CG 5. Any other key concerns

We consider that opportunities are missed relating to digitalisation and innovation. WPD has a strong track record of developing and managing processes to deliver outputs but falls short of genuinely integrating innovation and digitalisation across the business (paragraphs 5.6 to 5.10).

WPD's plan relies on uncertainty mechanisms working effectively, and there is as yet insufficient detail for us to assess their effectiveness (paragraphs 5.1, 5.3, 6.2 and section 7).