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**Access and Forward-looking Charges Significant Code Review: Consultation on Updates to Minded to Positions and Response to June 2021 Consultation Feedback**

Dear Patrick

Thank you for the opportunity to respond to the above consultation. This response is on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc.

We welcome the further clarity on key aspects of the proposed arrangements under this Significant Code Review (SCR) and remain supportive of achieving the objectives they seek to implement. We have provided responses to the specific questions asked in your consultation in the appendix to this letter. While we are generally supportive of the minded-to proposals including these updates, there are two areas which we are concerned may limit the successful achievement of the objectives of this SCR:

**Timescales**

As we continue to approach the implementation date of 1<sup>st</sup> April 2023, meeting timescales for key milestones and decision points is becoming more critical. The minded-to proposals constitute a significant and complex change to the current rules regarding charging for connections and users' access to the distribution system. Making the required changes will require modifications to be made to industry codes which involves navigating the required governance and change control. The timescales necessary to meet the requirements of this governance are already ambitious leaving little room for delays. It is therefore important that Ofgem and the Working Groups supporting the implementation of this reform meet expected deadlines for making decisions and provide the required clarity to support each next step in the process.

Additionally, we are already working in parallel with the SCR implementation process to get our company systems, processes and people ready to deliver on our customers' expectations when this reform goes live. We are committed to continuing to provide an excellent experience by supporting our customers through this major change to connections and access arrangements.



Any delays to decisions being made and clarity of policy being provided will frustrate our efforts in this regard, potentially putting the achievement of the wider benefits of this reform at risk.

We encourage Ofgem not to delay the publication of their Final Decision and we will provide support through the Working Groups and otherwise as necessary to help meet this important deadline.

### **Unlimited liabilities**

As explained in our response to the original minded-to consultation, we are concerned that Ofgem's proposals expose network operators and potentially DUoS bill payers to unlimited liabilities with respect to procurement of flexibility to cover excess curtailment. While we support the introduction of a limit to curtailment for customers on non-firm connections and the obligation to take efficient steps to avoid exceeding this limit, we are concerned that the proposed arrangements could lead to excessive costs that do not deliver any additional benefit to customers as a whole.

As explained in detail in our response to question XX of this consultation, we believe network operators could credibly find themselves in a situation in which customers with a non-firm connection could be in a position of power as the sole-provider of flexibility where other sources of flexibility cannot provide the required service. In this situation, these customers could feasibly demand disproportionate payments for provision of flexibility – at a price far in excess of the value being provided to the system and the wider DUoS-paying customer base. Through our existing flexibility programme we have supported market-based approaches to procurement of flexibility services and will continue to support this approach where it can deliver enduring benefits to customers. However, we can foresee a situation where the new proposals will put a legal obligation on a network operator to procure flexibility with no viable alternative, even in the event of a market not being able to provide the service at an efficient price.

We have provided a proposed alternative approach that would address Ofgem's concerns with a "backstop" approach while providing sufficient protection from excessive costs associated with procuring flexibility in low-liquidity situations. We believe this would strengthen the proposed arrangements and more closely align them with the objectives of the SCR in particular facilitating Net Zero at the lowest cost to consumers. We would welcome further engagement on this topic to develop alternative proposals in more detail to ensure the Final Decision presents the most effective reform of access arrangements.

We reiterate our support for the work of this SCR and will continue our active role in working with Ofgem and the wider industry to ensure successful implementation to maximise benefits to consumers and wider society. If you have any questions on this response, please do not hesitate to contact me in the first instance.

Yours Sincerely



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## Appendix – Responses to consultation questions

### Question 2a:

i. Do you believe that it is necessary to introduce a High Cost Cap (HCC) for demand, and to retain one for generation?

Yes, we believe it is necessary to introduce a HCC for demand and retain one for generation.

In reducing or removing the location signal from connection charges, the risk of inefficient investment is increased, placing undue burden on DUoS customers. In the case of demand connections, the complete removal of reinforcement charges from connection offers opens this risk substantially. Both through our own analysis of historic quotations and together with the industry SCR implementation working group, it is clear that, with no reinforcement cost signal, there would be a very large increase in inefficient reinforcement investment costs. A preliminary analysis over the last four years shows that 7% of connections offers which incorporated reinforcement would have costs above a threshold of £1,200/kVA and this small number of offers account for 33% of the reinforcement costs quoted. A high-cost cap (HCC) for demand connections, set at an appropriate level, would act as a safeguard for DUoS customers against much of this inefficient investment and UK Power Networks support this proposal.

We have undertaken a similar analysis for generation connection offers and we believe the same logic applies. Accordingly, we support the retention of the HCC for generation.

ii. Do you believe that our proposals to do so represent sufficient and proportionate protection for DUoS billpayers against excessively expensive connections driven reinforcement?

Given the national objectives to drive towards a zero-carbon economy, we believe the proposed HCC controls should provide sufficient protection for DUoS bill-payers, provided the respective HCC thresholds for demand and generation connections are set at an appropriate level. If set too high, then the control would be ineffective and DUoS bill-payers would not be sufficiently-protected. We are committed to providing support to further analysis in order to set HCC thresholds at appropriate values.

It should be noted that in the absence of other measures there are potential ways to 'game' the HCC rule; a connecting customer could elect to increase their requested load to reduce the reinforcement cost per kVA. In isolation the HCC would not provide sufficient protection, but together with the approach outlined in this consultation towards speculative applications (see also response to question 2c) and distribution network operators taking a holistic view over what load will actually materialise from a connection request, it is our view that the overall package of measures is suitable to provide adequate DUoS bill-payer protection.

iii. What are your views on retaining the current 'voltage rule' to determine whether the HCC is breached (ie considering the cost of reinforcement at the voltage level at point of connection and the voltage level above)?

We support retention of the voltage rule in the HCC application as outlined. Assessment at only the point of connection voltage would not offer sufficient protection for DUoS bill-payers, again, based on our analysis of historic quotations. Conversely, extending the voltage rule to consider up to two voltage levels above the point of connection may act to hinder connections. It can be argued DNOs will be better-placed to make more strategic investments at higher voltage levels to minimise overall system cost, given the appropriate regulatory arrangements to do so.

iv. What are your views on the principles we have proposed to determine an appropriate HCC level for demand, including the potential for this to be set at a different level to generation under these principles?

UK Power Networks support these principles. Given that the reinforcement charging proposals for demand and generation connections are different, it is entirely appropriate that the respective HCC levels are set at different values.

**Question 2b:** What are your views on our proposals to maintain the requirement for three-phase connection requests to pay the full costs of reinforcement, in excess of Minimum Scheme (ie lowest overall capital cost)?

The concept of the Minimum Scheme is used throughout the distribution connection charging policy and the principal that a connecting customer, if specifying an enhancement above the Minimum Scheme, contributes any additional cost is sound. In line with this, it is our view that if a load can be met with a single-phase connection, the cost for an enhancement above this should be met by the connecting customer, rather than socialised to all DUoS bill-payers.

Further, if seeking the minimum overall cost solution, the connecting customer in almost all cases would be able to purchase a single-to-three-phase converter at substantially less cost than the cost to upgrade a part of the distribution network to three-phase.

In this context, we fully support the proposals to maintain the requirement for three-phase connection requestors to pay the full costs of reinforcement in excess of the Minimum Scheme. Given this is the current rule and proposed rule for the future, we believe that should a network operator want to offer three-phase upgrades as standard, the additional cost to provide this should not be passed on to DUoS customers.

We assume that where customers wish to upgrade their connection to a standard fuse size, the HCC should not apply. We request Ofgem to make this explicit in the Final Decision of this SCR.

**Question 2c:**

i. Do you agree with our proposals to maintain the current treatment of speculative connections and is there a need for further clarification on the definition of speculative connections?

Yes, we support the proposal to maintain the current treatment of speculative connections and also to further clarify the definition of speculative connections.

As outlined above in our response to 2a ii, retention of speculative treatment will complement the HCC application for demand and generation connections and we support the proposals as outlined. The definition of speculative development is currently open to a reasonable degree of interpretation and we support further clarification and consistent application across network operators.

ii. Do you agree that our wider connection boundary proposals broaden the disparity between connections deemed to be speculative versus non-speculative? If so, do you believe this needs to be addressed and how?

Yes, the disparity between treatment of speculative versus non-speculative development will widen. We believe there are a number of steps that can be taken, as set out below.

The nature of speculative development is that there is a risk reinforcement is not ultimately required, but only after the investment has been made leading to the stranding of what is ultimately unnecessary investment funded by DUoS customers. Changing the connection charging boundary does not change this risk in any way. This widening disparity of treatment underlines the importance of further clarification and consistency between network operators towards speculative developments.

Further clarification is required on the applicability of the ECCR legislation to subsequent connections where initial connections were deemed speculative. Whilst not part of this consultation, we support the application of ECCR to drive reimbursement of an initial contributor where the initial contributor's connection was deemed speculative.

**Question 2d:** Do you consider that our proposed DUoS mitigations (a demand HCC, and retaining reinforcement payments for three phase and speculative connection contributions) present a cohesive package of protections for DUoS billpayers? Do you consider these proposals to interact in any way that could counter their effectiveness, and if so, how?

Yes, we believe these proposals present a cohesive package of protections for DUoS bill payers.

There is interaction between these three measures of protection outlined in our responses to 2c i and 2a ii which indicates these are a complimentary set of measures. We have not identified ways in which they would interact to counter their overall effectiveness.

**Question 2e:** Do our updated proposals to treat storage in line with generation for the purposes of connection charging simplify charging arrangements for these sites and better align with the broader regulatory and legislative framework?

On balance yes, the updated proposals simplify charging arrangements for these sites and better align with the broader regulatory and legislative framework.

Whilst the charging treatment becomes simpler from a connections perspective, we can identify with storage applicants who may express frustration if their reinforcement is chargeable as a result of this treatment in cases where the network constraint is based on the demand aspect of the storage asset. However, given the arguments on the relative locational flexibility of generation and storage assets when initiating a project compared to a typical demand connection, on balance, we support Ofgem's view that the pricing treatment for storage aligns with that of generation.

**Question 2f:** Do you agree with our proposals regarding the treatment of in-flight projects (ie that they should not be permitted to reset their connection agreement and retain their position in the queue), noting they retain the right to terminate and reapply from 1 April 2023 should they wish to be treated under the proposed connection charging boundary?

Yes, we agree with the proposals regarding the treatment of in-flight projects.

The approach outlined appears to be reasonable and fair. Where business cases have supported the acceptance of connection offers made under the existing connection charging boundary, nothing within these proposals will change this. Equally, if a connection customer is able to cancel an existing contract and then apply for a new connection, it would be discriminatory to prevent this. We agree that when taking this action, the new application should be treated on its own merits and that the customer would join any interactivity queue in line with any other new applicants, without benefitting from the original queue position. Similarly, any planned delivery schedule associated with the initial connection application, were it to be cancelled, would be forfeited.

**Question 2g:** Do you agree with our proposals to retain the existing arrangements for managing interactive applications? Do you agree with our proposals on the treatment of unsuccessful applicants (that the connection charges at original application date will continue to apply if queue position is retained)?

Yes, UK Power Networks supports this position, in line with our response to question 2f.

**Question 2h:** Do you agree with continuing with the definition of the Minimum Scheme as currently set out in the CCCM? Do you believe this definition requires any further clarification or amendment, and if so, why?

Yes, at this point in time, given the nascent market for flexibility, we support continuing with the current definition of Minimum Scheme as currently set out in the CCCM.

**Question 2i:** Are there any risks associated with our proposals to allow current non-firm connected customers to seek a firm connection following the changes proposed by our SCR? Do you agree that existing non-firm connected customers that do seek a firm connection should be processed through existing queue management processes as determined by DNOs?

We have identified the following risks with allowing current non-firm connected customers to seek a firm connection:

- Costs that DUoS bill-payers will be exposed to, especially in light of the potentially limited whole system benefit from avoiding what could be minimal curtailment;
- Availability of resources, both regionally and nationally, to undertake this work. Given that these resources will be utilised across new connections activity and wider programmes of work, this creates a risk that the drive to net zero may be slower or less cost efficient as a result.

Without impartial treatment of these existing non-firm connection customers, however, it is difficult to identify any alternatives to Ofgem's proposals. As such, we support the approach to process these requests via existing queue management processes.

**Question 2j:** How necessary do you consider Ofgem intervention in Electricity Distribution Standard Licence Conditions 12, 15 and 15A? What duration might such measures be needed, or acceptable, following 1 April 2023? What value do you place on certainty of connection timeframes compared with time to connect?

UK Power Networks will work with connecting customers to identify ways to minimise any fluctuation in quotation work volumes. It is hoped that this proactive approach will deliver a better customer experience from 1 April 2023 as well as an easier transition internally.

However, it is difficult to predict exactly how customers will respond and against a backdrop of increasing quotation volumes, it seems appropriate that some flexibility with regulatory quotation timescales is applied. Given that timescales for LC12 and LC15A extend to 3 months (or 65 days), 6 months would be the minimum period from 1 April 2023 worth considering in order to provide any tangible relief.

**Question 3a:** Do you agree with our proposal to exclude customer interruptions and transmission constraints from the definition of curtailment with respect to distribution network access arrangements?

We agree with these proposals.

### **Customer interruptions**

Current and planned electricity distribution price control mechanisms already cover circumstances where customers experience interruptions to their power supply. The proposed arrangements for non-firm access cover circumstances where a customer is connecting with a known constraint. Therefore we believe the new arrangements only need to cover circumstances where known constraints lead to the need to restrict a user's access to the system and price control arrangements such as the Interruptions Incentive Scheme and Electricity Guaranteed Standards will cover scenarios where loss of supply occurs, there should be no double-jeopardy for network operators.

### **Transmission-driven curtailment**

Ofgem have made a decision to exclude transmission access arrangements from the scope of this SCR. Since the access rights proposals only apply to distribution, we believe the arrangements should only apply to distribution system driven curtailment.

However, it is important that in situations where there is likely to be curtailment driven by transmission constraints that the impact on customers' network access is clear and communicated in a transparent way. This will ensure that customers are able to make the right choices for their connection to the system. We propose joint work through the current Access Delivery Group or separately through the Electricity Networks Association to form common guidance for how transmission-driven curtailment is dealt with alongside the implementation of distribution system access rights to ensure consistency for customers.

**Question 3b:** Do you agree that the curtailment limit should be offered by the network based on maximum network benefit and agreed with the connecting customer?

We agree with this approach. This will ensure that the customer gets an accurate view of the expected curtailment for their connection in their connection offer, enabling them to make an informed decision based on their specific needs. It will also help ensure that obligations on network operators are reflective of the local network circumstances and what levels of access can reasonably be provided in advance of any deeper reinforcement.

**Question 3c:** Do you have any views on the principles that should be applied to ensure curtailment limits are set in a consistent manner?

Yes, we do. Below we have set out our views on the principles we believe should be applied to ensure curtailment limits are set in a consistent manner, both across connectees and across licensees operating at the distribution level.

### **Transparency**

As highlighted in this consultation, curtailment limits will need to be set based upon the ability of the local distribution network to support the user's requirements. To ensure users have confidence that limits set by the network operator are a reasonable reflection of this, the process must be transparent and allow effective communication of the limit and the factors behind how it has been derived.

## Consistency

In line with the point above, it is important that users receive a consistent experience across GB under the proposed arrangements for non-firm access. It is therefore important that the process designed for setting curtailment limits generates consistent limits for given network constraints. Differences in curtailment limits derived for customers should be due to differences in network conditions rather than differences in how network operators have calculated limits.

## Simplicity

Under the new proposed arrangements, it is likely that non-firm access arrangements will be more prevalent for connections in the future. Therefore, it is important that the process developed to calculate curtailment limits is as simple as possible while generating fit-for-purpose values for limits. This will ensure that network operators are able to produce connection offers with minimal administration and indirect cost in timelines that customers expect, otherwise the additional bureaucracy will fall on DUoS customers to fund, resulting in further upward pressure on bills. It will also aid in achieving transparency as users will be better able to understand the calculation for their curtailment limit.

**Question 3d:** Do you agree with our proposal not to introduce a cap for flexibility payments made should any curtailment in excess of agreed limits be required?

No, we disagree with this proposal.

We are concerned that the proposal to not include a price cap for flexibility payments does not reflect the risk associated with the wider proposed arrangements and is likely to lead to unintended customer behavior and a risk of higher costs for DUoS customers.

Our interpretation of the proposed non-firm access arrangements is that if curtailment exceeds the limit agreed with the customer, the network operator will have a legal obligation to procure flexibility to cover this excess curtailment either from the wider market or directly from the curtailed customer. This puts the network operator in a position where, if the wider market cannot provide the required flexibility, then the curtailed customer can name their price in such circumstances. DNOs are not funded for uncapped liabilities and failure to address this issue creates an unacceptable risk exposure which we would challenge. We believe this generates a significant risk for the following reasons:

### Current approach to procurement of flexibility

Under our current process for procurement of flexibility to address future demand, there is a natural limit to the price paid for flexibility as it is assessed against a Net Present Value equivalent of the reinforcement option. This ensures that the most efficient cost solution is adopted between traditional and flexible solutions based on what the market can provide.

### Under proposals for non-firm access, there will be no viable alternative

Our interpretation of the proposals for non-firm access from 1<sup>st</sup> April 2023 is that if the curtailment limit agreed with the customer is exceeded, the network operator must procure flexibility to address this. In most circumstances, reinforcement will already be underway to provide the customer a firm connection with the non-firm access being used as a temporary arrangement while work is carried out. This will mean that under these new arrangements, with the timescales involved, there will be no viable alternative to benchmark flexibility prices against. This will leave network operators in a position where with low liquidity, high prices may have to be accepted to meet contractual

arrangements within the connection agreement. Discussion are ongoing regarding how the cost of procuring this flexibility will be funded but it has the potential to be a significant and inefficient increase in costs to consumers.

### **Low liquidity and market-failure**

Flexibility will have to be procured from users within the same network constraint for it to be able to mitigate the curtailment i.e. the pool of providers is geographically limited. This narrows down the market that can be accessed to provide the required flexibility. It is possible that in some circumstances this limited market will not be able to provide the flexibility required to avoid exceeding the curtailment limit agreed with the customer. This will mean that the only option for procuring the required flexibility will be to procure it from the user that is being curtailed. Without an effective market to provide true price discovery, the price bid for this flexibility may be abnormally high and bear no relation to either the cost to the user or to the value being provided to the network. This will mean that DUoS customers are facing inefficient costs which are misaligned to the value being provided to the network. Furthermore, this money will be flowing to the connected user resulting in windfall gains. We do not believe this situation is equitable and controls should be put in place to avoid this occurring.

### **Unlimited liability**

Network operators are under a statutory obligation to connect customers to the network. Fundamental to fulfilling this obligation is entering into bilateral connection agreements with connecting customers which govern their use of the system. Under the proposed SCR arrangements, these connection agreements will include mandatory obligations on network operators to procure flexibility in the event that the curtailment limit agreed with the customer is exceeded. As described above, this situation is likely to occur due to volatility in curtailment events driven by external events such as severe weather and other user behaviour. The mandatory nature of this obligation constitutes a liability for the DNO related to the cost of procuring this flexibility. If the price of this flexibility is not capped using a reasonable backstop arrangement, this liability itself is essentially uncapped – exposing the network operator (and potentially DUoS customers) to an unlimited financial liability. We do not believe that such arrangements are suitable and proportionate for the situation that the regulations are looking to cover. Please see below for our proposal of a reasonable alternative which will ensure curtailed customers receive fair compensation for excess curtailment but limits the financial exposure of network operators and DUoS bill payers to a cost reflective value for the flexibility being procured.

### **Materiality**

Due to the multiple uncertainties associated with these arrangements it is hard to accurately assess the materiality of this issue. However we have carried out a high level comparative analysis to highlight the potential difference in flexibility costs if no cap is set for the price of a unit of flexibility. Our analysis is appended to this response but in summary:

Assuming:

- Circa 1,500MW of capacity connected under non-firm arrangements while reinforcement is being delivered
- One exceptional year in the RIIO-ED2 period leading to curtailment beyond agreed limits
- An exceptional year would lead to the need to curtail 25% of customers at 1% above their agreed capacity

The cost of procuring this flexibility at a typical market rate of £200/MWh would be c. £6.57m.

However, assuming 10% of this flexibility had to be procured at a higher rate of £8,000/MWh (we have received many bids at such prices in genuine tender events, and some as high as £24,000/MWh<sup>1</sup>) the cost increases to £32.19m.

Although the cost has increased nearly fivefold, the value provided to the network and wider users remains the same. We do not believe this represents value for money for customers as a whole and do not believe regulation should be set in a way that would allow this situation to manifest.

### **Proposed alternative solution**

We fully appreciate the value of certainty to customers connecting to the network, especially under non-firm arrangements where their access to the network can be curtailed. We therefore agree with the proposal to agree limits of curtailment with customers connecting under these arrangements and do not propose a cap on the volume of flexibility that a network operator must procure to ensure these limits are not exceeded. However we do believe that it is important to set a price cap on the unit-cost of the flexibility that must be procured. We note Ofgem's concerns about distortion of developing flexibility markets and the need to maintain the incentive on DNOs to take action to limit curtailment and to procure flexibility using a market-based approach where possible.

These concerns can be mitigated while still protecting DUoS customers from excessive, inefficient costs by setting the unit price cap of flexibility procured to cover excess curtailment at a suitable rate that is indexed to wider, efficient market rates with an appropriate uplift. This will maintain the incentive on DNOs to explore alternative solutions to curtailment and also ensure any distortion to active markets is minimised. For example, using the same assumptions as our sensitivity analysis described above and appended, if a cap were set at market rate plus 100% (i.e. twice the typical market rate), the increase in cost from a market-based total of £6.57m to an absolute maximum of £13.14m if all flexibility were procured at the rate of the cap. This represents a saving of c. 60% (£19.05m) against the uncapped price approach while delivering the same value to the wider system and ensuring the flexibility provider is appropriately compensated for the service provided. We believe this provides an essential protection for DUoS customers while addressing Ofgem's concerns of a price cap. This cap could be updated at regular intervals to ensure that as markets develop, the rate is set at an appropriate level to avoid any distortions.

**Question 3e:** Do you agree with our proposal to introduce explicit end-dates for non-firm arrangements? Are there any mitigations for DUoS billpayers we should consider?

Yes, we agree with the proposal to introduce explicit end-dates for non-firm arrangements.

Explicit end-dates for non-firm access arrangements will be an important factor for users to understand how their connection will fit their needs. We agree that explicit end-dates should be provided to users as part of their connection offer. End-dates should have the same regulatory treatment as energisation dates currently supplied to customers as part of connection offers/agreements to allow flexibility in customer needs and delivery.

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<sup>1</sup> We have used these exceptional yet genuine bids from real-world tender events to demonstrate the possible prices that could be payable if market liquidity is low and no protection mechanisms are put in place. These bids were not accepted in the associated tender events and do not represent the outcome of an efficient flexibility market.

**Question 3f:** Do you have views on whether the end-dates should take into account only current known or likely works, or if it should allow time for wider developments to take place?

These end-dates should be clearly linked to the specific work required to deliver the user's connection and any other known or anticipated connections and wider demands in the area served by the network. While a pause to consider or wait for potential additional needs to be communicated may allow more efficient solutions to be delivered, we believe the risk of unnecessary delays to known connections outweighs this. Network operators should make use of forecasting and stakeholder engagement to inform decisions on what network reinforcement is required but any "pause" to starting work should only be considered if it does not impact the customer-driven timescales of known connections.

**Question 3g:** Do you have any comment on our proposal not to further define or standardise time-profiled access arrangements?

We agree that there is limited benefit from standardising time-profiled access rights at this time. We will continue to provide such arrangements to customers who will benefit from them. However, these arrangements tend to be very specific to the user in question and what spare capacity is available on the local network that would support their connection. Standardisation would potentially frustrate this process while not offering any material benefit over a bespoke approach.

**Question 5a:** Has the additional information in this consultation affected any of the views you previously submitted in response to our June 2021 consultation (if so, in what way)?

Where our views on the policy intent have been impacted by the additional information in this consultation, we have explained this in the response to the individual questions above.

Some of the updated proposals (notably the High Cost Cap and no price cap on flexibility procurement) will have an impact on the costs submitted to Ofgem in the M30a/b memo BPDT tables as part of our RIIO-ED2 Final Business Plan. Where this is the case we will continue to work with Ofgem through the established Working Groups to agree the appropriate route to provide updated cost forecasts and the impact these will have on our overall RIIO-ED2 Business Plan.

**Question 5b:** Do you have any other information relevant to the subject matter of this consultation that we should consider in developing our proposals?

Not at this time.