

Appendix 1a – Load Issues summary

The proposed licence includes a “*toolkit*” of uncertainty mechanisms that Ofgem plans to introduce to manage the uncertainty associated with load-related expenditure. These mechanisms need to be designed to operate together to enable DNOs to be responsive to changing demand.

Ofgem set out one of its objectives of these mechanisms as “*ensuring the networks are not a blocker to net zero by having sufficient funding to invest in network capacity and that low carbon technologies do not face installation or operational delays*”. As currently drafted, the conditions are at risk of failing to achieve this effect.

This core “*toolkit*” of mechanisms is established via a range of documents including:

- Special condition 3.2 - Uncertain Costs Re-openers
- Special condition 3.3 - Evaluative Price Control Deliverables
- Special condition 3.9 - Load related expenditure volume drivers
- Special condition 3.11 - Net to gross adjustment for Load Related Expenditure
- Special condition 6.1 - Pass-through items
- Load Related Expenditure Re-opener Guidance
- Load Related Expenditure Volume Drivers Governance Document
- Price Control Financial Model

The issues that we have identified with the scope and operation of this “*toolkit*” of documents arise due to issues in individual documents and issues with the interaction between them.

Considerable work is required to achieve load-related conditions which function effectively. We have proposed the main changes that are required to achieve this and include them in the detailed issues log.

The issues that we have identified are individually material and cumulatively huge. In summary:

- The combined scope of the Load Related Expenditure Re-opener and the Load Related Expenditure volume drivers is unclear. This leads to uncertainty as to whether some load-related activities are included at all, as well as the potential for very different interpretations of the required calculations of Load Related Expenditure Re-opener allowance adjustments.
- The boundary between the Load Related Expenditure Re-opener and the Load Related Expenditure volume drivers is unclear. This leads to confusion as to whether all load-related activities are addressed within the toolkit of activities. In particular, it is unclear whether several load-related activities at 11kV and below are addressed by either mechanism.
- The scope of the Load Related Expenditure Re-opener “trigger” does not recognise that a difference may exist between the DNO’s forecast demand and the basis of Ofgem’s RIIO-ED2 ex-ante allowances in the Final Determinations. It also does not include changes to the proportion of forecast expenditure that will be funded by DUoS customers. It is important for the condition to clearly state that changes due to any difference between Ofgem’s assumptions and the ultimate load constraints on the network that may be included in any re-opener application.
- The process to be followed in the case of “red flag” volume driver “check metrics” is unclear, incomplete and based on data that have not historically been reported and may be subject to reporting inconsistencies. This leads to a risk that a “failure” of one metric leads to protracted

and intrusive discussions about the efficiency of volumes as well as uncertainty of allowances for all relevant volumes. In turn, this risks DNOs delaying key investment due to concerns about whether volumes will be allowed.

- The text and calculations in Special Condition 3.9 are internally inconsistent and also inconsistent with inputs expected by the draft PCFM shared with DNOs. It is crucial that it is clear whether relevant calculations are to be calculated to replace ex-ante allowances or to make adjustments relative to ex-ante allowances, and that – in turn – these align with the intended operation of the PCFM. The current inconsistency leads to the risk that materially incorrect totex allowances may be calculated.
- The process for potentially modifying the load related expenditure volume drivers condition mid RIIO-ED2 has not been established correctly. It is essential that text is included on the face of the licence setting out the time, manner, and circumstances in or under which such a modification may be made.
- The boundary between pass-through and the Load Related Expenditure Re-opener is not clearly defined. It currently seems likely that allowances for transmission connection point charges will be partially double counted.
- It is premature to assume that all Strategic Investment projects should be subject to evaluative PCDs. Furthermore, the definition of Strategic Investment is too broadly defined and may result in an inappropriately large number of relatively small projects being subject to PCDs leading to disproportionate processes being introduced.
- Ofgem's proposed continuation of the net to gross adjustment for Load Related Expenditure condition into RIIO-ED2 needs much more consideration. Ofgem has not consulted on this proposal and the proposed drafting is unclear. For example, it double counts Totex Incentive Mechanism adjustments and introduces a risk of unconstrained allowance modifications. Additionally, several important calculations that are required to calculate any adjustment are not clearly defined. This leads to a risk of unexpected or unwarranted adjustments to allowances for Load Related Expenditure.
- Furthermore, the net to gross adjustment for the Load Related Expenditure condition has not been drafted in a manner that is compatible with Ofgem's proposed approach to setting baseline allowances for years 1 and 2 on a different basis to years 3 to 5 in respect of the outcome of the Access SCR. It is highly likely that all DNOs will trigger this mechanism as a direct consequence of the difference between Ofgem's assumptions in setting baseline allowances and the charging basis introduced following the Access SCR.
- The proposed net to gross adjustment for Load Related Expenditure also does not include a proposed range. More consideration should be given to the width of the deadband, especially in light of Ofgem's approach to setting allowances to reflect the Access SCR.
- Special Condition 3.11 Part B suggests an inappropriate expectation that DNOs will deliver a specific percentage of Gross Load Related Expenditure via Specific Customer Funded Reinforcement. This suggests that DNOs should somehow manage their investment to keep the ratio of work that is part-funded by connecting customers and that funded by existing customers within a particular range. This would be a very unhelpful and potentially counter-productive obligation that could stand in the way of delivering for customers. In the context of Ofgem's proposed approach to setting allowances for the outcome of the Access SCR, it

may also conflict with the requirements of the Common Connections Charging Methodology. It should be removed.

- The timings of the mechanisms do not align and may lead to “boundary issues” in the operation of the mechanisms. Furthermore, the Load Related Expenditure Re-opener cannot be triggered in time to confirm allowances for year 3 of RIIO-ED2. Given that Ofgem proposes not to adjust baseline allowances for year 3 to take account of the outcome of the Access SCR, this means that DNOs will have no certainty of allowances for year 3 at the time that they are required to commit to expenditure.

It is also important that baseline allowances are set in a manner that is consistent with the expected operation of the various uncertainty mechanisms. Any inconsistency between the way in which baseline allowances are set and the way in which the mechanisms are expected to operate may result in double counts or gaps in the allowances that are ultimately adjusted through licence modification. These issues are further compounded by the complexities associated with Ofgem’s proposed approach to setting baseline allowances following the outcome of the Access SCR. The overall effect of this suite of issues is to create significant uncertainty as to whether key, load-related activities will be appropriately funded during RIIO-ED2. DNOs must be provided with detailed information underpinning the assumptions made by Ofgem in setting allowances in order for the re-opener to operate appropriately.

Once the issues in the core “*toolkit*” of documents have been resolved, further work will be required to ensure that the core mechanisms interact correctly with other RIIO-ED2 conditions. We have identified the following further conditions that need to correctly interact with the toolkit of load-related uncertainty mechanisms:

SpC 3.2 Storm Arwen Re-opener	May result in fundamental changes to system planning standards which could include, for example, changes to interconnection standards (normally be categorised as LRE)
SpC 3.6 Net Zero	Definition of Net Zero Development includes “ <i>new investment arising from the agreement of a Local Area Energy Plan</i> ” – commonly these would result in LRE
SpC 3.7 Co-ordinated Adjustment Mechanism	May transfer LRE projects (including Strategic Investments) between DNOs or between ED and T May move costs from TCP to LRE or vice versa
SpC 3.8 Green Recovery	Some Agreed Schemes may deliver load-related outcomes
SpC 9.X Whole System Strategies	Policy and condition not yet made available, but may affect expenditure that could be categorised as LRE