

Appendix 3 – Re-opener issues

We have concerns around the clarity of the re-opener conditions in the proposed licence. Given the number of re-openers in RIIO-ED2 and the scale of applications that may be made, we believe the resolution of these issues should be a priority for Ofgem. Our concerns can be broadly grouped as follows:

- re-opener drafting that is not consistent with the legal requirements of the EA89;
- re-opener drafting that fails to achieve the effect expected by policy; and
- inconsistency in drafting approach that further confuses the intended operation of the re-openers.

In the RIIO-T2 CMA appeal, the CMA confirmed that Ofgem can introduce a licence condition which has a mechanism for its later modification (what Ofgem referred to as “self-modification” conditions). This is permitted under section 7(5) of the Electricity Act 1989 (the EA89).

However, any “self-modification” licence condition must meet the requirements of section 7(5) of the EA89. In the RIIO-T2 appeal, the CMA confirmed, in line with the statutory requirements, that, in order for such a condition to be lawful, the condition must specify the: (a) time; (b) manner; and (c) circumstances in or under which a modification can be made.

If such criteria are correctly set out in the condition itself, the licensee in question should be able to understand the potential impact on it of a future modification at the outset of the price control simply by reference to the condition.

This note addresses five key issues that we consider must be addressed to ensure that the re-openers can be fully understood, that they work in practice, and so that they satisfy the section 7(5) EA89 requirements:

- the wording used to require “evidence of efficiency” in order to make a modification is unclear and too ambiguous (see Section 1);
- the process that will be followed when the Authority triggers a re-opener is unclear and requires clarification (see Section 2);
- inconsistency in the use and presentation of the materiality thresholds (see Section 3);
- clarification of the scope of certain re-openers (see Section 4); and
- the importance of using consistent language throughout the re-openers to remove the potential for confusion and unintentional distinctions (see Section 5).

1. Proposed “evidence test” wording is unclear

Twelve¹ of the re-opener mechanisms set out that the Authority may only make modifications under each of the re-openers if (variations of) “*there is evidence to demonstrate that the modification to allowances is efficient*”.

Without change or elaboration, we do not believe that this wording sufficiently specifies the circumstances under which a modification can be made. It is therefore not possible for licensees to understand the potential impact on them of a future modification. It is not sufficiently clear to understand how the requirement will be met in practice. Specifically:

¹ All re-openers, except the Co-ordinated Adjustment Mechanism (CAM)

- (i) It is not clear whether it is dependent on the companies providing the requisite evidence to satisfy the test up front, or if it could be met following Ofgem's assessment of the representations. For example, it is assumed that Ofgem would carry out an assessment of efficiency, after receipt of information on costs from the licensee. In such circumstances, the outcome of Ofgem's analysis could constitute the requisite evidence. However, this is not what the condition says. The requirement is for evidence to *exist* that demonstrates that the modification to allowances is efficient. This, combined with the lack of methodology or criteria relating to any potential assessment by Ofgem of this evidence, means that it is difficult to fully understand the implications of any proposed modification.
- (ii) Given the nature of uncertainty that exists in the areas that have re-opener conditions, it is very likely that there will be situations where it is difficult to show independent evidence or conduct analysis to prove that the modification to allowances is efficient. For instance, where a proposed project or activity is innovative or where there is a lack of historical or comparative data to allow analysis to demonstrate "efficient" costs but where it is obvious an allowance should be made. In addition, in a number of areas the need for additional allowances will be driven by changes in legislation or other requirements, which may not otherwise be justifiable as "efficient".
- (iii) Ofgem does not specify a methodology or set of criteria for what is to be considered "efficient". This has the potential to allow Ofgem to make an arbitrary assessment of efficiency which may not reflect the actual efficient costs to individual licensees of the activities for which funding is being requested, or reflect wider benefits of any potential intervention (e.g., environmental or societal).

Whilst section 7(5) is intended to allow for modifications whose scale is uncertain at the outset of the price control period, there should not be uncertainty about the tests to be applied in determining whether such a modification should be made. The inherent ambiguity in the language proposed by Ofgem does not provide the requisite level of specificity. The uncertainty in the process, combined with the lack of clear methodology or criteria relating to the substance of any potential assessment by Ofgem of this evidence, means that it is difficult to fully understand the implications of any proposed modification, including the circumstances in or under which a modification can be made.

There is a significant concern, therefore, that the ambiguity inherent in the "evidence of efficiency" wording may be applied in such a way as to result in a legitimate re-opener application being rejected by Ofgem. This is because by explicitly including "efficiency" as a criteria, but failing to provide sufficient clarity about what it means in this particular context, or how it will be assessed, it provides an easy route for rejection of re-openers on a basis which, when limited to judicial review grounds, would be very difficult for a licensee to challenge.

We propose two alternative solutions, either of which would mitigate these concerns:

- Replace the "evidence of efficiency" test with a provision allowing Ofgem to assess that *"the licensee has provided such detailed supporting evidence as is reasonable in the circumstances"*; or
- Replace the "evidence of efficiency" test with a (positive) power to apply an adjustment for inefficiency to licensees' applications where Ofgem has conducted an assessment and has concerns. Suggested wording of a new sub-clause within each re-opener could be *"Where the modification has been requested by the licensee under paragraph x.x.x, the Authority may undertake an assessment of the efficiency of those costs and, where inefficiency is found, the Authority may reduce the value requested by the corresponding amount"*.

These alternatives would allow Ofgem to act if either it felt that insufficient evidence had been provided, or it had undertaken an assessment and identified areas of inefficiency. For the second option, the re-opener guidance must then expand on the efficiency review process.

2. Process for Authority instigated re-openers is unclear

Seven of the re-openers set out in special condition 3.2 include provision for the Authority to “instigate the re-opener”. However, the conditions are silent on the process that the Authority would follow when instigating the re-opener and do not sufficiently specify the circumstances under which a modification can be made. It is therefore not possible for licensees to understand the potential impact of a future modification on them.

It is possible that when setting policy in each of these re-opener areas, there may have been some confusion and conflation of the process of Ofgem directing a new and additional window for the re-opener (following which licensees submit their applications as they would under the pre-set windows) and the process for Ofgem instigating a re-opener at any time.

Indeed, under issue number 23 from the special condition 3.3 Part D ESR issues log, a request for guidance on the process around Ofgem instigating the re-opener was requested. This issue was closed by Ofgem because Annex 6 to the Re-opener Guidance Associated Document had been drafted to set out the process “*that the Authority will undertake when considering whether to direct a re-opener window under the Electricity System Restoration Re-opener*”. It should also be noted that such guidance only exists for the ESR re-opener and not for the other eleven re-openers where Ofgem can direct an additional window.

To clear up this confusion, we believe Ofgem needs to:

- (i) Confirm whether the processes around directing an additional window and instigating a re-opener are the same or different.
- (ii) Include a new additional sub-condition under SpC 1.3 Common Procedures in the licence, which clarifies the processes around directing an additional window and/or instigating a re-opener under SpC 3.2 (depending on the answer to (i) above).
- (iii) Include a new sub-clause within each relevant re-opener licence condition to clarify that, before making a modification as a result of instigating the re-opener, the Authority has:
 - a. requested from the licensee and been provided by the licensee with such detailed supporting evidence as is reasonable in the circumstances,
 - b. given an explanation of the rationale for the proposed direction and the basis of the calculations used in any modified allowance, and
 - c. clearly stated that the relevant circumstances under which the Authority may trigger the re-opener are the same as the circumstances under which a licensee may trigger the re-opener.

In the absence of providing this additional clarification, it is questionable whether this aspect of the relevant re-openers is consistent with the legal requirements of Section 7(5) of the EA89.

In addition, there are further concerns with the inappropriate way in which some of the re-openers operate and these are outlined below:²:

² To note, this is not an exhaustive list. DNOs may individually submit separate specific issues as part of their response to the informal licence consultation. The list specifically excludes and issues relating to the LRE re-opener, LRE volume driver, cyber re-openers and associated conditions.

3. Materiality threshold

Within our response to the Draft Determination proposals, we set out our major concern with Ofgem's proposal to apply a 1% baseline revenue common materiality thresholds despite this being set at 0.5% in other sectors. We have not reiterated those concerns here, but the licence drafting has also flagged some issues with other aspects around the application of materiality thresholds:

- (i) The wording used to describe the application of the materiality test is phrased inconsistently in different re-openers. It is not always clear whether the materiality threshold is to be assessed relative to the amount of allowance that has previously been provided, either via baseline allowance or under an earlier re-opener application. This makes the scope of the re-opener unclear and some DNOs who may legitimately expect an allowance adjustment may not be entitled to one. For those conditions where it is Ofgem's policy that a materiality threshold should apply, we suggest that the following standard wording be used: *"The [XXX] Re-opener may be used where there has been a change in the [XXX] costs the licensee has incurred or expects to incur, relative to any previous allowances for such costs, that exceeds the Materiality Threshold"*.
- (ii) The definition of Materiality Threshold is currently not populated. We are unclear whether Ofgem's intention is to include a table in the definitions list showing the Materiality Threshold that is applicable to each DNO. Given that these are key values that are relied on by many different conditions they would merit a more prominent location in the Licence, and we suggest adding a new appendix to special condition 3.2.
- (iii) Some re-openers have materiality thresholds and others do not. Initial verbal clarification from Ofgem to allow DNOs to understand the rationale behind this was that those re-openers that relate to compliance-related activities would not have a materiality threshold as licensees should not have to face financial exposure from mandatory requirements. Following this logic through, the materiality thresholds should be removed from the Environmental and Storm Arwen re-openers.

4. Clarification of scope

In addition to our separate feedback on the various load-related and cyber uncertainty mechanisms, we believe that two uncertainty mechanisms still require some policy work to ensure the key definitions are updated to set the correct scope.

- (i) Wayleaves and Diversions re-opener: The definitions of Wayleaves and Diversions Costs must capture:
 - All Land Rights i.e., Servitudes, Easements Leases and Freeholds too (not just wayleaves) The types of land right selected affords the DNO the option of securing the most appropriate land right for the apparatus and the ability to obtain a secure land right in perpetuity and deliver the correct compensation due to the grantor, in effect resulting in an economic and efficient approach by removing any future threat to the apparatus.
 - It should be clear that this definition covers the land rights for existing electric lines and substations as well as for new ones installed as a result of a diversion.
 - The commercially negotiated compensation to grantors. This is a key cost within this process and grantors have a legal right to receive such compensation.
 - Those claims received prior to RIIO-ED2 but not paid until RIIO-ED2. If Ofgem limits the scope to NEW claims received in RIIO-ED2, this would create a perverse incentive for Land Agents to abandon a previously lodged, queued claim and resubmit it during RIIO-ED2. The timing of the claim submission is largely irrelevant because it could

relate to assets that are decades old. The key date is the payment date or expected payment date.

- (ii) PCB Interventions volume driver: Although this is a volume driver and not a re-opener, we believe it is important to set out our concerns regarding the current definition of PCB Interventions. Ofgem has recently acknowledged³ that both associated asset interventions and ground-mounted transformers may be required as part of PCB Interventions work in certain circumstances, but the definition of PCB Interventions does not currently allow for:
- Associated asset interventions required to support the pole-mounted transformers (such as poles and pole-mounted transformers). There will be instances where the pole mounted transformers cannot be replaced with these associated assets also being replaced; or
 - Replacement of ground-mounted transformers where the forecast load growth exceeds the capacity that can be supplied by a PMT.

We suggest the PCB Interventions definition is amended as follows: *“in the context and scope of the PCB Interventions Volume Driver, means any work undertaken by the licensee on pole-mounted transformers and associated poles and pole-mounted switchgear in order to comply with the PCBs Regulations and such work may involve the installation of a ground-mounted transformer in circumstances where the forecast load growth exceeds the capacity that can be supplied by a pole-mounted transformer.”*

PCBs *“has meaning given to that term at Regulation 2(1) of either of the PCBs Regulations.”*

PCBs Regulations means:

“In the case of England and Wales, the Environmental Protection (Disposal of Polychlorinated Biphenyls and other Dangerous Substances) (England and Wales) Regulations 2000, and any amendment to it.

In the case of Scotland, the Environmental Protection (Disposal of Polychlorinated Biphenyls and other Dangerous Substances) (Scotland) Regulations 2000, and any amendment to it.”

5. Inconsistency in drafting approach further confuses the intended operation of the re-openers

It is helpful to have the opportunity to review all conditions side-by-side as part of this consultation. In doing so, we note that a variety of similar, but not identical, phrases are used to set out the circumstances and conditions that must be met for a modification to be made.

The variation in wording compounds the issues explained above and also introduces more scope for differences in interpretation. We understand that this inconsistency is not intentional. The concern is that anyone trying to interpret them in the future will assume that, as the wording is slightly different, this was to reflect a different policy intention or approach.

In particular, there are drafting inconsistencies across the common re-opener conditions whereby only seven of the Parts in 3.2 state upfront that the re-opener *“may be used where the licensee has incurred*

³ Fraser Glen during SPEN bilateral 11/10/22

or expects to incur” additional costs. Although this is stated later within the drafting of the other conditions, it is not immediately obvious, and it is important that all re-opener conditions within the licence are drafted consistently to avoid any ambiguity. Consequently, a similar statement should be included in those conditions from which it is currently missing (Physical Security, Electricity System Restoration, Cyber OT, Cyber IT and Storm Arwen).

In addition to the drafting changes to address the specific issues that we set out above, we also include details in the table below of aspects of the condition that are phrased inconsistently. Where appropriate, we also include our view of the form of words that should be used consistently throughout the condition.

Section	Comments/ wording	Action required	Changes needed to
This part establishes ...	Consistent across all re-openers	No action required	
The *** re-opener may be used where...	PSUP, ESR, Cyber x 2 and Storm Arwen do not have costs incurred or expected to be incurred here	Change to include this clarity	3.2.6, 3.2.21, 3.2.44, 3.2.52, 3.2.68
The licensee may only apply ...	Inconsistency - some Parts say "during such other periods as the Authority may direct", whilst others say "during such other periods as the Authority directs"	This should be consistent. It should also refer to the process for directing an additional window and/or instigating a re-opener discussed in section 2 above.	All parts of 3.2 should be checked and corrected where necessary
The licensee may only apply ...	Inconsistency - some Parts say "may only apply to the Authority for modifications to this licence", whilst others say "may only apply for modifications to this licence"	Correct where the words omit "to the Authority"	3.2.15, 3.2.30, 3.2.45, 3.2.53, 3.2.613.2.76, 3.2.84, 3.2.91, 3.2.106, 3.2.113, 3.2.120
The licensee must, when making an application under the... send to the Authority a written application that:	These are naturally different depending on the re-opener itself, but the final 3 should be consistent - see below		
	sets out any modifications to the value of *** in Appendix 1 being sought	All Parts of 3.2 should be checked and corrected where necessary	
	explains the basis for calculating any modifications requested to allowances and the profiling of those allowances	All Parts of 3.2 should be checked and corrected where necessary	
	provides such detailed supporting evidence as is reasonable in the circumstances	All Parts of 3.2 should be checked and corrected where necessary	3.2.8(f), 3.2.77(g)
An application under this Part must:	Again, naturally different depending on the re-opener itself, but some should be consistent:		

	be confined to costs incurred or expected to be incurred on or after 1 April 2023	All Parts of 3.2 should be checked and corrected where necessary	each re-opener has a slight variation of this wording - suggest all are changed in line with 3.2.9(b) " <i>(b) be confined to costs incurred or expected to be incurred on or after 1 April 2023</i> "
	take account of allowed expenditure which can be avoided as a result of the modifications requested	All Parts of 3.2 should be checked and corrected where necessary	suggest that all re-openers align to the wording used in 3.2.47(c) " <i>(c) take account of allowed expenditure which can be avoided as a result of the modifications requested</i> "
The following modifications to this licence may be made under the *** Re-opener:	First sub-bullet generally varies to the individual re-opener		
	modifications to the value of *** set out in Appendix 1	All Parts of 3.2 should be checked and corrected where necessary	
	modifications confined to allowances for Regulatory Years commencing on or after 1 April 2023	All Parts of 3.2 should be checked and corrected where necessary	
The Authority may only make modifications to this licence under the *** Re-opener by direction:	This opening sentence differs - in some re-openers it ends with "where", and in others, the corresponding bullets begin with "where"	One style should be chosen and then used consistently in 3.2	
	Sub-bullet 1 usually varies with the individual re-opener	Consistency can be gained	some list all the links to the trigger, but others say " <i>where the circumstances in *** exist</i> " - the latter is a more effective way of addressing this point. This should be the default wording for consistency
	the requirements in paragraphs x.x.x and x.x.x have been met	Consistency can be gained	This may vary depending on whether it is licensee only trigger or licensee and Authority - in which

			case there are extra links to the trigger paragraph
	where there is evidence to demonstrate that the modification to allowances is efficient (or similar words)		See section 1 above

