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Joanna Gaches,
Senior Manager, Networks
Ofgem
10 South Colonnade,
Canary Wharf,
London E14 4PU

17 January 2023

Dear Joanna,

SSEN Distribution response to the RIIO-ED2 Licence Drafting Statutory Consultation

1.1 SSEN Distribution welcomes the opportunity to respond to Ofgem's RIIO-ED2 licence drafting statutory consultation. This letter and Appendix 1 outline the outstanding issues we have identified that require to be resolved prior to the modifications to the licence taking effect. The outstanding issues on the load related licence conditions are detailed in Appendix 2. Additional issues are detailed in the relevant licence drafting logs, which are enclosed as Appendix 3. Please note that our full response is uploaded on Huddle.

Self-modification Procedure

1.2 We note that significant improvements have been made to SpC 3.2 following concerns raised in response to the informal licence drafting consultation that the previous drafting did not meet the requirements of Section 7(5) of the Electricity Act. In particular, the addition of Part S to this condition, setting out that Authority instigated reopeners will be made under Section 11A of the Electricity Act, provides additional clarity. However, we still have some issues with the drafting, and we require some further changes to ensure that the condition fully meets the requirements specifically in relation to the efficiency test and the timing of a decision. Please see further detail on this in Appendix 1.

Uncertainty Mechanisms

1.3 SpC 3.2 Part O provides a re-opener for costs associated with identifying a long-term sustainable whole system solution to ensure security of supply for the Hebrides and Orkney. The current licence drafting does not recognise the overarching purpose of the re-opener, which is to ensure that the appropriate options for cable replacement and augmentation are selected to provide the optimal solution for the region. The optimal solution will be confirmed once our analysis has been completed; until that time there remains uncertainty on the exact scope of the works. The optimum whole systems solution must consider the long-term sustainability solutions to back-up generation, which is excluded from the current scope of the re-opener. By listing specific cables for delivery within the licence condition, Ofgem is not enabling us to ensure the selected final whole system approach and associated cables meet the expectations set out in the Final Determination and does not enable us to consider any future technologies that may benefit the project. The list of cables should be removed from the licence drafting, or an appropriate provision must be made to ensure the mechanism can fund us appropriately to deliver the right whole systems solution.

1.4 SpC 3.2 Part Q provides a re-opener for Shetland Extension Fixed Energy Costs (SEFEC). The current licence drafting is not correct as it provides for two re-opener windows, the second of which

can only be used if the first re-opener window has been triggered. We do not expect to use the first re-opener window but may require triggering the second re-opener window if the actual SEFEC is +/-10% of the allowances we have been given. This should operate in the same manner as in ED1. We believe this to be an error rather than policy intent and have provided alternative drafting in the relevant licence drafting log.

Control Room

1.5 We note that the definition of New Control Room has significantly changed from the version provided previously. The new definition specifically relates the PCD to the preferred option for the new control room as specified in our engineering justification paper (EJP). This is overly restrictive and does not take into account the multi-facetted nature of a construction project. The preferred option as set out in the EJP was the preference at the point of submission. However, there are a number of key stages at which a project can change and where a secondary option would need to be consider, a key example being at planning permission stage. If planning permission was not granted by the local authority, then we would require considering alternative options. We have proposed a revised definition in the relevant licence drafting log.

Load Related Licence Conditions

1.6 A number of significant issues remain with the load related licence conditions, as discussed with Ofgem in the meeting with the DNOs on 10th January 2023. In general, these issues result from confusion and confliction between the various load related licence conditions, governance documents and workbook. Further detail is provided in Appendix 2.

Treating Domestic Customers Fairly

1.7 We note the improvements that have been made to the Treating Domestic Customers Fairly licence condition. Our outstanding concern relates to the use of "Domestic Customer outcomes". This term introduced consideration of customers' feelings, experiences or expectations, which do not necessarily mean that the customer was treated unfairly. References to Domestic Customer outcomes should be removed from the guidance as they are not part of the obligations set out in the licence condition. Further detail is provided in the relevant licence drafting log.

Best vs Reasonable Endeavours

1.8 We maintain our views with Ofgem's proposed move from "reasonable" to "best" endeavours, specifically in relation to tariff setting and in the new Treating Domestic Customers Fairly licence condition on a DNO to account for factors that may not materialise or even be identifiable at the relevant point in time, and strongly disagree with Ofgem's proposals. A best endeavours obligation could require a DNO to account for all potential events, and lead to a licence breach if a DNO fails to do so. A DNO will always risk breaching these licence conditions if the actual tariff set does not reflect the forecast, given a DNO is obligated to use best endeavours to forecast accurately. This is a change with significant implications in terms of the steps that DNOs would be required to meet, specifically it may require a DNO to subordinate its own commercial interests and incur expenditure or a loss.

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<u>Next steps</u>

1.9 As outlined in our response to this consultation there are several outstanding issues in relation to the licence drafting for RIIO-ED2. These should be resolved prior to the modifications to the licence being implemented. We are happy to discuss any of our comments in more detail should this be helpful.

Your sincerely,

Clothilde Cantegreil

Head of Regulatory Strategy, RIIO-ED2

North of Scotland
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Central Southern England
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Appendix 1 – Material issues

CONCERN 1: SpC 3.2 and the self-modification process

We are concerned that under the current drafting of SpC3.2, a modification to allowances would only be made for each uncertainty mechanism "where the modification to allowances is efficient". Firstly, this wording could be read to mean that it is the modification or the modification process itself that must be efficient, rather than the revised costs which we believe to be the intent. Secondly, and more importantly, **Ofgem does not specify a methodology or set of criteria for what is to be considered "efficient"**. Under section 7(5) of the Electricity Act 1989, 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.

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 efficiency 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. As an alternative, we propose: "the licensee has provided such detailed supporting evidence as is reasonable in the circumstances."

The current drafting of SpC 3.2 does not provide any timescales in which a decision on a re-opener application will be made by the Authority. Given the number of uncertainty mechanisms in ED2, the new 'best endeavours' obligation in relation to tariff setting and the potentially large sums involved, uncertainty on the timing of decisions creates a significant issue for licensees. We recognise that some information is provided in the RIIO-2 Re-opener Guidance and Application Requirements, but considering the significance of this, we consider that information relating to the timing of decisions should be on the face of the licence. propose that wording similar to that in the ED1 licence would be appropriate to mitigate this: "the Authority will, within three to six months of the close of the relevant application window." This would provide the required certainty for licensees. A further issue in relation to SpC 3.2 is detailed under Concern 3 below.

CONCERN 2: RIIO-2 Cyber Resilience IT and OT PCD Reporting Guidance introduces adjustments that conflict with SpC 3.3

1. **The confidential nature of the documents involved here**

Note that this issue relates, in part, to mechanisms that are set out in Appendix 4 of the RIIO-2 Cyber Resilience IT and OT PCD Reporting Guidance ("Appendix 4"), which is a confidential document. Therefore, we have provided only minimal details here that we do not consider include confidential information.

We think the level of detail provided here should be sufficient for Ofgem to understand and resolve the issues. However, we can provide further details if the Ofgem team requires it.

2. **Conflict between licence documents regarding the cyber OT UIOLI mechanism**

During the overall RIIO-ED2 consultation process, Ofgem considered whether it was appropriate to include in the licence a Use It or Lose It ("UIOLI") mechanism in respect of the Cyber resilience PCDs. The outcome was that Ofgem removed the Cyber resilience UIOLI mechanism from the informal consultation version of the licence.

Ofgem did not include the Cyber resilience UIOLI mechanism on the face of the relevant licence condition (SpC 3.3 Evaluative Price Control Deliverables) in the statutory consultation version of the licence.

However, Appendix 4 to the RIIO-2 Price Control Deliverable Reporting Guidance and Methodology Document regarding Cyber Resilience OT and IT reporting ("Appendix 4") contains references to Ofgem applying a UIOLI mechanism or a form of UIOLI mechanism for PCDs funded under Cyber Resilience Operational Technology plans and Cyber Resilience Operational Technology Re-opener applications. There is, therefore, a significant conflict between the licence and Appendix 4.

Appendix 4 has the status of an Associated Document. Consequently, it is subordinate to the licence, the provisions in the licence take precedence and there is no provision for a UIOLI mechanism in the licence i.e. the licence does not provide for any such adjustment to be made and SpC 3.3 sets out specific circumstances under which the Authority may adjust the cyber OT allowances (CROTt and CROTREt values). An underspend situation is not one of the scenarios in respect of which the Authority has given itself the ability to adjust allowances in the licence.

For example,

- 3.3.15(a) sets out that "where an output is Fully Delivered With An Alternative Specification and the licensee demonstrates that any underspends against the associated allowances are attributable to Efficiency or Innovation, <u>the Authority may not make any adjustment</u> to the associated allowance".
- 3.3.15(d) sets out that where the output is Partially Delivered or Partially Delivered With Alternative Specification the Authority may direct an adjustment to the associated allowance <u>only</u> in accordance with the given formula.

We note that there is some ambiguity in the FDs regarding this issue. We do not believe that a UIOLI adjustment is required in respect of cyber OT. The evaluative PCD adjustment process is sufficient to protect customers because the mechanism in SpC 3.3 allows for the clawing back of any allowances

associated with Price Control Deliverables (PCDs) that are ultimately not delivered under relevant circumstances.

We therefore believe that the most appropriate course of action for Ofgem to take is to:

§   Confirm that no UIOLI mechanism will apply to cyber OT and that any ambiguity in the FDs is wrong (i.e. there is an error in the FD drafting);

§   Carry out a complete review of Appendix 4 to ensure that it is drafted in a way that is consistent with Ofgem's intended policy, with all references to UIOLI adjustments and mechanisms being removed; and

§   Consult again on Appendix 4 to ensure that those changes are implemented correctly.

However, if Ofgem disagrees and does intend to apply a UIOLI adjustment to cyber OT, some fundamental changes are required to SpC 3.3 and to Appendix 4 (these are expanded on in the sections below) to:

- ensure that they are drafted in a way that is internally consistent;
- avoid any double counting between adjustments for PCD non-delivery and adjustments for underspend via UIOLI; and
- ensure that the UIOLI adjustment operates at an overall cyber OT programme level, and not against individual PCDs.

2.1. Drafting issues that would need to be resolved in order to correctly introduce a UIOLI mechanism for cyber OT

Without prejudice to our view that a UIOLI mechanism for cyber OT is not necessary, the following issues would need to be resolved in order for a UIOLI mechanism to be correctly implemented via the licence and Associated Documents:

Issue 1 - UIOLI mechanism needs to be included on the face of SpC 3.3:

As explained in section 1 above, the UIOLI adjustment is not included on the face of SpC 3.3. An underspend situation is not one of the scenarios that the Authority had given itself the ability to adjust allowances for in the licence.

The UIOLI adjustment needs to be recognised on the face of SpC 3.3. Without the recognition of this in SpC 3.3, the adjustments envisaged in Appendix 4 could not be made.

Any UIOLI mechanism would need to be included into SpC 3.3 (rather than SpC 3.4 with other UIOLI mechanisms) so that the interaction with the adjustments (of the same PCFM variable values) under SpC 3.3 Part C is clearly articulated in a way that avoids any double counting.

The mechanism would need to follow the style of algebraic approach used in SpC 3.4 for other UIOLI adjustments, but evolved to reflect the fact that allowance adjustments may have already been made under SpC 3.3 Part C. DNOs have previously provided drafting to Ofgem that would provide for a UIOLI mechanism in SpC 3.3 that correctly interacts with adjustments permitted under Part C of SpC 3.3.

<u>Issue 2 - Appendix 4 conflates PCD adjustments and UIOLI adjustments in a way that risks introducing double counts</u>

The hypothetical examples in Appendix 4 give rise to a risk of double counts between evaluative PCD adjustments and UIOLI adjustments that could result in inappropriately large adjustments being made to allowances.

The hypothetical examples in Appendix 4 seem to conflate the two separate adjustments. For example, they wrongly include UIOLI mechanisms being used to make adjustments for non delivery of a PCD. SpC 3.3 would envisage such adjustments being made following the process in Part C of SpC 3.3.

These inconsistencies give rise to a risk of double counts between evaluative PCD adjustments and UIOLI adjustments that could result in inappropriately large adjustments being made to allowances.

Any UIOLI mechanism needs to be introduced in a way that avoids any double counting of allowance adjustments between PCD non-delivery adjustments and UIOLI adjustments. Principles need to be established to ensure that, in combination, these two adjustments lead to appropriate allowance values being determined, with no double counting of adjustments.

<u>Issue 3 - any UIOLI adjustment needs to operate at a programme level, not the level of individual PCDs</u>

The hypothetical examples in Appendix 4 suggest that UIOLI adjustments may be made at an individual PCD level, rather than a programme level. For DNOs with more than one cyber OT PCD, this risks the UIOLI mechanism being incorrectly applied to individual PCDs rather than at programme level, meaning that DNOs cannot offset overspends in one PCD against underspends in another.

Figure 1 (Application of use it or lose it mechanism for cyber resilience OT PCDs) of Appendix 4 recognises that the two adjustments should be separate adjustments, and that the UIOLI mechanism operates at a whole programme level. However, the specific examples included cause doubt as to how the two separate mechanism would operate. For example, hypothetical examples 10, 11 and 13 all incorrectly refer to making UIOLI adjustments at an individual PCD level.

Any UIOLI mechanism needs to operate at a programme level, not an individual PCD level.

2.2. Required Changes

In order to resolve these issues, changes need to be made to:

- Introduce a UIOLI mechanism into SpC 3.3, making it clear how that mechanism interacts with the evaluative PCD mechanism and avoids any double counting adjustments.
- Amend Appendix 4 such that the application of the evaluative PCD mechanism is clearly separated from UIOLI assessment in hypothetical examples.

3. Conflict between licence documents regarding evaluative PCD adjustments

In a number of instances, the hypothetical examples set out in Appendix 4 propose adjustments to allowances that are inconsistent with the specific circumstances set out in SpC 3.3 under which the Authority may adjust the cyber OT and cyber IT allowances. For example:

- Sub paragraph 3.3.15(c) only allows for the reprofiling of allowances where re-profiling would have a material impact on allowances, whereas Appendix 4 hypothetical example 9 suggests that allowances would be re-profiled for Delayed PCDs, with no reference to a check on the material impact;
- Sub paragraph 3.3.15(d) only allows for allowance adjustments to be made using the formula set out in SpC 3.3.15(d), whereas Appendix 4 hypothetical example 11 suggests that the adjustment will be calculated based on the level of underspend against allowances; and,
- Sub paragraph 3.3.15(a) says *'where an output is Fully Delivered With An Alternative Specification and the licensee demonstrates that any underspends against the associated allowances are attributable to Efficiency or Innovation, the Authority may not make any adjustment to the associated allowance'*. However, Appendix 4 hypothetical example 10 shows Ofgem adjusting the PCD allowance down using the UIOLI mechanism, with no check to see if the underspend is due to efficiency or innovation.

The hypothetical examples in Appendix 4 must be updated so that that the examples are consistent with the specific circumstances set out in SpC 3.3 under which the Authority may adjust the cyber OT and cyber IT allowances.

4. Confusion regarding the applicability of the Totex Incentive Mechanism (TIM) to cyber PCDs

We note a number of instances where there seems to be confusion as to how the allowance adjustments that may be made SpC 3.3 interact with the operation of the TIM.

The Price Control Financial Model will automatically calculate allowance adjustments associated with the operation of the TIM in any instance where a difference between allowed totex and actual totex exists.

In combination with the operation of the PCFM, the allowance adjustment mechanisms set out in SpC 3.3 will automatically result in adjustments via TIM if the DNO's expenditure is different to the associated allowances (where appropriate, including RPE allowances and after any adjustments under SpC 3.3 to reflect the delivery of evaluative PCDs). We think this is correct.

Appendix 4 seems to suggest that an adjustment to allowances would be required in order to enact the TIM adjustments (for example hypothetical example 8). However, this is not the case.

Appendix 4 should be updated so that it does not suggest that further allowance adjustments are required in order to achieve the sharing of any under- or over-spend via the TIM.

CONCERN 3: The relevant ex ante values that must be taken into account in re-opener applications must be set out on the face of the licence

Most of the re-openers in SpC 3.2 (Uncertain Costs Re-openers) require that the DNO provides evidence that the allowances that are being applied for are not included within ex ante (non-variant) allowances that are provided in the Final Determination. The various Parts of SpC 3.2 require this in different ways, depending on the nature of the re-opener, for example:

- "additional costs associated with such changes" (SpC 3.2.6)
- "relative to the assumptions used by Ofgem to set allowances" (SpC 3.2.14)
- "is not provided for by ex ante allowances" (SpC 3.2.75(c))

With the exception of those re-openers that have opening Price Control Deliverables (PCDs) ascribed in SpC 3.3, the value of the relevant ex ante allowances is neither set out on the face of the licence nor elsewhere. It is also not possible to infer the value of those ex ante allowances from any of the other licence documents.

The relevant values can also not be identified or inferred from the cost assessment output files that Ofgem has shared with DNOs, because the ultimate allowances are not presented at a sufficient level of disaggregation.

The DNOs, therefore in almost all circumstances, have no visibility of the relevant values that must be considered when demonstrating that the "tests" in SpC 3.2 have been met, or in proposing the values of allowance modifications that are required by the associated application requirements. This creates the risk of protracted discussions at the time of re-opener applications and the potential for applications to be inappropriately disallowed or reduced.

Given how the licence conditions have been expressed with regards to ex ante allowances, the relevant ex ante allowance values for each re-opener need to be formally recorded.

DNOs must be provided with the annual allowances that align to the scope of each re-opener that are included in ex ante allowances in order that they can meet the requirement to provide an annual profile for the proposed allowance adjustments, for example by providing DNOs with an updated version of the RIIO-ED2 Licence values and calculations document with these values included. The associated allowance calculations must also be provided for full transparency on the basis by which they have been derived.

It is imperative that DNOs are given the opportunity to check these values prior to modification notices being issued.

Each Part of SpC 3.2 also makes reference to modifications to allowances being made relative to the re-opener terms in Appendix 1. Appendix 1 is currently completed as showing 'N/A' across all terms and years. Modifications cannot be requested against 'N/A'. Therefore, these need to be amended to show zero.

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CONCERN 4: Allowed Network Asset Risk Metric expenditure - transposition

The sign convention used to calculate allowance adjustments in SpC 3.1 is erroneously based on the assumption that NARMS risk reduction is measured in the Network Asset Risk Workbook as a positive value. In fact, both targets and delivery are measured as negative numbers in the Network Asset Risk Workbook. This sign convention inconsistency results in materially incorrect allowance adjustments being calculated via the formulae in SpC 1.3.

This error is unintentional. We have already provided Ofgem with details of the changes that are necessary to correct the error. For completeness, we set out the required changes below.

Reference *(Part X, Para Y)*	Comment	Suggested alternative drafting (if necessary)
3.1.30	The 'greater than or equal to' and 'less than or equal to' signs are the wrong way around. Because the targets and delivery is measured in risk reduction (i.e. a negative number) the signs need to be the other way around.	$[NRO_{BL} * (1 + DB_L)] \bullet NRO_{OA} \bullet [NRO_{BL} * (1 + DB_U)]$
3.1.31	The < sign is the wrong way around. Because base line risk and delivery are defined with negative numbers, an under-delivery is actually a greater number than the baseline. i.e. if delivery was -9 and the target was -10. This represents an under-delivery, but -9 is greater than -10.	$NRO_{OA} > [NRO_{BL} * (1 + DB_L)]$
3.1.32	As per above, the > sign is the wrong way around.	$NRO_{OA} < [NRO_{BL} * (1 + DB_U)]$

3.1.35 and 3.1.37	NRO(OAD) is calculated in two different ways depending on whether the delivery is under or over the Baseline Network Risk Output. The calculations are set out in 3.1.35 and 3.1.37, however the introductory text does not make clear which it is referring to, therefore this should be made explicitly clear.	3.1.35 - If the licensee has been deemed to have un-justified an under-delivery against its Baseline Network Risk Output then the Determined Outturn Network Risk Output (NROOAD) is derived in accordance with the following formula: .... etc 3.1.37 - If the licensee has been deemed to have justified an over-delivery against its Baseline Network Risk Output then the Determined Outturn Network Risk Output (NROOAD) is derived in accordance with the following formula:...... etc
3.1.36	The determination of the term UCR(AD) is incorrect. Because both the UCR (BL) and UCR (OR) are negative numbers, the definition stating that the Adjusted Unit Cost of Risk is the 'lower of' these two terms gives a larger unit cost to multiply to calculate the NARM(AD) value. We do not believe this is Ofgem's intention. We believe the intention is to multiply by the most efficient unit cost, and thus, given the negative terms, this should be the "higher of".	UCR_{AD} - is the Adjusted Unit Cost of Risk (£/£risk), which is the **higher** of the Baseline Unit Cost of Risk (UCR_{BL}), derived in accordance with 3.1.38, and the Outturn Unit Cost of Risk (UCR_{OR}), derived in accordance with paragraph 3.1.39.

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CONCERN 5: Use of the term "manifest error"

The term "manifest error", which is used in four special conditions, is not defined and so gives rise to uncertainty as to what is meant by the concept of "manifest error" and what is the nature and effect of the presumption in the relevant conditions. This uncertainty should be addressed by making "Manifest Error" a defined term.

SpC 3.9.13 provides that, for the purposes of SpC 3.9.12 (which identifies by reference to SpC 3.9.14 the categories of change that can be made to the Governance Document by direction), "*it is to be presumed that a modification which serves to correct a manifest error will have no impact on the licensee's Allowed Revenue*".

SpC 3.9.14(e) only provides an example as to the meaning of "manifest error" i.e. "*discrepancies between the* [Governance Document] *and the other special conditions*". which leaves open the question as to when a discrepancy amounts to a "manifest error", as opposed to merely an unintended outcome.

The importance of the precise meaning of "manifest error" depends in part on the nature and effect of the presumption in SpC 3.9.13. If the condition gives rise to an <u>irrebuttable</u> presumption that the correction of a "manifest error" will have no impact on a licensee's Allowed Revenue, that could only be potentially acceptable if the condition were to apply only to the correction of errors that the licensee must have known were drafting errors (such that it never in fact expected to receive allowed revenue in accordance with the erroneous provision). Stronger and clearer language is, therefore, required to establish an irrebuttable presumption that the correction of a "manifest error" will have no impact on a licensee's Allowed Revenue.

This would be achieved by including "Manifest Error" as a defined term in SpC 1.2, as follows:

> "*Manifest Error means a drafting error that is so obvious that no licensee could have relied on the error and/or expected to receive Allowed Revenue in accordance with its effects.*"

It should also be made clear that the presumption is rebuttable by the addition of "*(unless the licensee shows otherwise)"* such that SpC 3.9.13 reads:

> "*For the purposes of paragraph 3.9.12, it is to be presumed (unless the licensee shows otherwise) that a modification which serves to correct a Manifest Error will have no impact on the licensee's Allowed Revenue*".

As the term "*manifest error*" is also used in other special conditions, this change would bring clarity to each of those conditions. The term "*manifest error*" should, therefore, be capitalised in SpC 3.1.8(c), SpC 3.9.13, SpC 3.19.14(e), SpC 8.1.4, SpC 8.1.5(e) and SpC 9.2.20(e).

The principle noted in paragraph 3.5 also applies to SpC 8.1.4, which should, therefore, read:

> "*For the purposes of paragraph 8.1.3(b), it is to be presumed (unless the licensee shows otherwise) that a modification which serves to correct a Manifest Error will have no impact on the licensee's Allowed Revenue*".

CONCERN 6: Amendments required to SpC 1.3 (Common Procedure)

In general, we support the concept of the introduction of common procedures in SpC 1.3. The standardisation of processes across equivalent mechanisms is welcome and aids readers' ability to follow and understand the licence.

However:

- A number of the processes are incompletely drafted and require expansion; and
- The common processes need to be correctly and consistently cross-referenced from the other conditions that they are relevant to.

A number of changes are required to implement these common processes correctly.

1. **The definition of Associated Document is unclear and does not provide certainty as to the scope of SpC 1.3 Part A**

The current definition of an Associated Document is:

> "means a document issued and amended by the Authority in accordance with Part A of Special Condition 1.3 (Common procedure) and any reference to an Associated Document is to that document as amended from time to time unless otherwise specified. It does not include the "ED2 Price Control Financial Instruments."

This definition is unclear and does not provide certainty as to scope:

- Ofgem's issues log suggests that the Regulatory Instructions and Guidance (RIGs) should fall into scope but the RIGs are not issued or modified under SpC 1.3 and SLC 46 confirms the associated process.
- As the RIIO-ED2 LRE Volume Drivers Governance Document and Network Asset Risk Workbook are licence instruments it should be clear that SpC 1.3 does not apply to the RIIO-ED2 LRE Volume Drivers Governance Document and Network Asset Risk Workbook, consistent with the ED2 Price Control Financial Instruments.

Consequently:

- The definition of Associated Document should list all of the Associated Documents that can be modified under SpC 1.3.
- The exclusion from the scope of Associated Document should be expanded to include all licence instruments.

2. **The process for Ofgem directing an additional Re-opener application window in SpC 1.3 Part B needs to be expanded**

We welcome the inclusion of Part B of SpC 1.3 in the licence. It is essential that the process via which the Authority will direct additional Re-opener application windows is clearly set out on the face of the licence such that it meets the CMA's criteria. However, the level of detail currently proposed is insufficient.

There should be more detail on how this process will work and the aspects that Ofgem will consider when deciding whether to direct an additional window.

The process needs to be expanded to explain:

- The process that Ofgem will follow if the DNO requests an additional window be directed;
- The factors that Ofgem may consider in deciding whether to direct an additional application window; and
- Any minimum time period between the date of the direction and the application window.

Proposed additional wording:

1.3.7 Where the licensee has requested that the Authority directs an additional period during which the licensee may make an application under a Re-opener, the Authority shall consider the information provided by the licensee, including any supporting evidence, when deciding whether to direct such additional period.

1.3.8 The Authority shall consider whether to direct such an additional period in situations where it believes that it is directly or indirectly in the Customers' interests to provide licensees with an additional opportunity to submit Re-opener applications.

1.3.9 The Authority shall make a decision on whether to direct an additional period as soon as is reasonably practicable.

1.3.10 Unless otherwise agreed with the relevant licensee, the minimum period of time between the date on which the Authority makes a decision regarding the direction of an additional period of time and the date on which the additional Re-opener application window closes will be 28 days.

Some further information is provided in the Re-opener Guidance Document (Appendix 12, paragraph 1.32). It would be helpful to include 'directly or indirectly' here to make it clear that there may be external factors that mean that a project or costs are necessarily delayed (which may not be directly in Customers' interests, but would be indirectly as it would mean that the costs would be recovered when they were more certain), as follows:

It may be appropriate to exercise this option in situations where we believe that it is <u>directly or indirectly</u> in ~~consumers'~~ <u>Customers'</u> interests to provide licensees with an additional opportunity to submit Re-opener applications. Prior to any such direction we would discuss the option with relevant stakeholders. For example, in a situation where external factors have led to the relevant project not being sufficiently advanced to allow a well evidenced application to be made during the window specified in the licence and we consider it is in the interest of consumers to allow a later submission.

3. The procedures in SpC 1.3 need to be consistently cross referenced from relevant conditions

It is important that the common procedures in SpC 1.3 are cross referenced from other conditions to which the common procedures apply. Without this cross referencing, it may not be obvious to the reader of a relevant condition that the common procedure in SpC 1.3 must apply.

This cross-referencing has been undertaken from conditions where Part A is relevant, but has not been undertaken for Parts B or C.

The process in Part B of SpC 1.3 needs to be cross referenced from all relevant conditions and Parts.

Proposed wording for all relevant conditions:

during such other periods as the Authority may direct <u>after following the procedure for the direction of additional Re-opener application windows that is set out in Special Condition 1.3 (Common procedure).</u>

The process in Part C of SpC 1.3 needs to be cross referenced from all relevant conditions and Parts.

Proposed wording for all relevant conditions:

unless otherwise directed by the Authority under Special Condition 1.3 (Common procedure), ….

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CONCERN 7: Issues and inconsistencies for Real Price Effects (RPEs) in various allowance modification processes

There are inconsistencies in the application of RPEs across a number of the allowance modification processes, relating to how RPEs are recognised in actual and forecast costs and in corresponding allowances. We do not believe these are intentional. We set out the issues and potential proposed solutions below.

1. RPEs and re-openers

RPE allowances are not being calculated in the Price Control Financial Model (PCFM) for reopeners (these are classed as 'RPEs Don't Apply').

At the time of making a re-opener application, DNOs may have already incurred some actual costs. DNOs may be applying for modified allowances to reflect both actual and forecast costs. Depending on the nature of the re-opener and the manner in which the DNO proposes to deliver the associated activities, there may be a need to reflect RPE allowances for forecast cost elements of a re-opener. This creates a potential disconnect between allowances for incurred actual costs, which rightly should not have RPEs applied as they will be implicitly included in actual costs, and allowances for forecast costs, which should be uplifted for RPEs.

Rather than a change in the PCFM (which may be complex across the actual and forecast costs included in the re-opener), we propose that an amendment is made to the RIIO-2 Re-opener Guidance and Application Requirements Document. An additional bullet point should be included in para 3.20 of this document allowing DNOs to apply for allowance adjustments that are inclusive of RPEs:

> *Including Real Price Effects for both actual costs and forecast costs*

This would ensure RPEs are accounted for in both actual and forecast costs with no further amendments being required in the PCFM.

2. RPEs and Use It Or Lose It (UIOLI) mechanisms

There are inconsistencies in the application of RPEs associated with the UIOLI mechanisms (for example, in relation to the Worst Served Customers term (WSCt) and the Visual Amenity Projects term (VAPt)). There are two separate issues:

1. The UIOLI allowance determined via the calculations in SpC 3.4 (Use It Or Lose It Allowances) will be either the value of the cap (which does not have RPEs embedded) or the value of actual expenditure (which will have RPEs embedded). The PCFM then classifies UIOLI as 'RPEs Apply' which double-counts RPEs if actual expenditure is used.

   To avoid this inconsistency, we propose that UIOLI allowances are categorised as 'RPEs Don't' Apply' in the PCFM. This then avoids the double-counting of RPEs on actual costs.

2. The cap in the licence has been calculated without any consideration of RPEs. This means that RPEs could artificially constrain (or inflate) the amount licensees can spend on these cost areas.

We suggest the values of the caps for each UIOLI allowance term in SpC 3.4 Appendices are uplifted by RPEs on an annual basis, using the updated annual RPE modelling assumptions. It would then also be correct that 'RPEs don't apply' in the PCFM, as per the amendment proposed in point 1 above.

3. RPEs and Evaluative Price Control Deliverables (PCDs)

Evaluative PCDs that are introduced for the start of the Price Control Period (including cyber and bespoke PCDs) are classed as 'RPEs Apply' in the PCFM. The values referenced in SpC 3.3 are pre-RPE, so for these baseline allowances it is correct that additional RPE allowances are calculated.

However, an issue occurs if Ofgem makes a decision to allow efficiently incurred costs for any non-delivered PCD, following the process in Part C of SpC 3.3. Assuming that "the costs of undertaking reasonable and necessary work until the decision to not deliver the output was made" referred to in sub paragraph 3.3.15(b) are based on actual expenditure as submitted in the PCD reports, there is a risk that RPEs will be double-counted.

We suggest that a solution would be for Ofgem to exclude the implied contribution of Real Price Effects that would be calculated using the methodology set out in chapter 5 of the Price Control Financial Handbook from the allowance values that it directs, so that once the indices are applied in the PCFM the directed values plus the associated RPE allowance equals the actual costs that Ofgem has determined should be funded by customers.

We believe that it would be sufficient to set out this methodological approach in the Price Control Deliverable Reporting Requirements and Methodology Document, probably by including an extra paragraph in chapter 5 (Adjustments to allowances) setting out that:

> *If Ofgem makes an adjustment for any relevant evaluative PCD allowance that (a) is calculated relative to actual expenditure and (b) adjusts allowances that attract RPE allowances in the PCFM, the Authority will direct allowances adjustments in such a way that, once the real price effect (RPE) allowances calculated in the Price Control Financial Model are taken into account, the total of the adjusted allowances and RPE allowances summates to the relevant actual costs.*

4. RPEs and Network Asset Risk Metric (NARM) expenditure

Network Asset Risk Metric Expenditure is classified as 'RPEs Apply' in the PCFM and so attracts RPE allowance. This is correct in the vast majority of most cases as the associated unit costs that are used to calculate ex ante assumptions will not have had RPEs included.

However, the calculation of the Outturn Unit Cost of Risk (UCRRORR) uses Incurred NARM Expenditure for the Price Control Period as an input, which will (implicitly) include RPEs. Incurred NARM Expenditure (used in the calculation of Outturn Unit Cost of Risk) is based on actual spend, which would reflect any RPEs experienced by the DNO. The unit costs calculated using that would then be further uplifted by RPEs.

- If RPEs are positive, the extra volumes associated with a Justified Over-Delivery would effectively be funded at greater than DNO's actual cost.

- But if RPEs are negative, the DNO would not be fully funded for the extra outputs.

This difference only matters if (a) if the DNO has a Justified Over-Delivery and (b) Outturn Unit Cost of Risk is lower than Baseline Unit Cost of Risk. But, because of the size of spend associated with NARMs, the difference could prove material.

We think the simplest solution is to amend the definition of Incurred NARM Expenditure so that actual expenditure is adjusted to reflect the RPE indices (so that once indexed by the RPE index the actual expenditure is calculated):

> *means the total expenditure incurred by the licensee during the Price Control Period on NARM Asset Interventions, adjusted to reverse the implied contribution of Real Price Effects that would be calculated using the methodology set out in chapter 5 of the Price Control Financial Handbook.*

CONCERN 8: Smart Optimisation Output timelines and Associated Document content

Introduction

The Smart Optimisation Output (SOO) outlines that its aim is to promote and enable effective collaboration between the licensee and its local stakeholders and communities, leading to better decision making and more coherent local energy planning. It has two principal deliverables as set out in Special Condition (SpC) 9.13 a Part 1 Collaboration Plan and Part 2 System Visualisation Interface. The requirement for these activities has only recently come to light, and there has been very limited discussion on this with no detailed Working Group sessions to ensure that the content of the Guidance document is understood by all DNOs. As it stands, the 'Core requirements' section of the Guidance document could result in very different interpretations from each DNO. Whilst we agree with the purpose, and strategy of the document, we have concerns that the lack of DNO wide discussion, and the unrealistic timescales, could undermine the realisation of the strategy in a meaningful and useful manner.

We firmly believe that Ofgem should not finalise the Guidance document until Ofgem and DNOs have been able work together to ensure the interface requirements are clearly articulated and understood by all. Once this process is complete, a realistic set of deliverables and deadlines can be set reflecting interactions with other working groups such as the Data and Digitalisation working groups, the Open Networks working groups and publications such as the DSAP.

Further detail:

The System Visualisation Interface in particular is described as 'a section of the DNOs website and open data portal that provides access to a package of forward-looking, open and accessible, digital network tools' and this should be accessible to stakeholders by 1st October 2023 with further developments in in place by 1st May 2024. Further, the guidance prescribes that information held on the System Visualisation interface should be determined collectively by DNOs and presented in a format and time horizon to be determined collectively by DNOs. To provide context to our concerns, this ask should be compared to the current work by all DNOs to standardise the LTDS which is a process that has taken several months so far and only relates to one set of data and information. The SOO guidance prescribes several data sets which must be standardised within a very short time period. Timescales are further challenged by the guidance prescribing that the data is to be made available through an Application Programming Interface (API) that is common across all DNOs, and we do not believe such commonality can be achieved in these timescales.

Notwithstanding our concerns on timelines and our request that the SOO guidance is not finalised until DNOs and Ofgem can set out the deliverables in a way that allows a realistic deadline to be set, we have specific drafting concerns which we believe could be addressed now:

- Para 1.12 In respect of both Parts 1 and 2, the licensee must collaborate with local stakeholders, to ensure that the SOO reflects the needs of customers and that work undertaken by licensees during RIIO-ED2, relevant to the future development of the wider energy system (e.g., for heat, natural gas, hydrogen, transport and storage), is accessible to, and informed by stakeholders.

  o The words in green set out a particularly broad obligation (with a must) and could arguably be construed to be ALL work undertaken by licensees. This should be more tightly constrained as follows: In respect of both Parts 1 and 2, the licensee must use

reasonable endeavours to collaborate with local stakeholders, to ensure that the SOO reflects the needs of customers. Work undertaken by licensees during RIIO-ED2, in relation to the SOO relevant to the future development of the wider energy system (e.g., for heat, natural gas, hydrogen, transport and storage), should be accessible to, and informed by, stakeholders.

- Para 2.2 DNOs must participate fully in the co-development of local area energy plans, net zero roadmaps and other strategies and cross-utility solutions, led by local and regional authorities and supported by the communities they serve, that will enable least cost decarbonisation pathways for power, heat and transport, where the involvement of the licensee is material in the successful planning and delivery of such strategies and solutions.

  o It is not the role of DNOs to develop or co-develop these plans and the extent to which we are able to be involved in the planning process will vary depending on the local or regional authority in question. Our role is to support, and the drafting should be updated as follows: DNOs must support the development of local area energy plans

- Para 3.1.1 Provide a representation of the DNO's existing network assets and associated constraints using both static and dynamic data. Such data should include the type, capacity, and location of assets and the location and specific nature of constraints, on all parts of the distribution network, at all voltage levels. Heat maps and raw data must be made available through an Application Programming Interface (API) that is common across all DNOs.

  o The word "known" should be included before "constraints".