

## *Response by Northern Powergrid (Northeast) plc and Northern Powergrid (Yorkshire) plc to the RIIO-ED2 Statutory Licence Modification Consultation*

This document is Northern Powergrid's response to the statutory consultation issued by the Gas and Electricity Markets Authority ("the Authority") on 14 December 2022, in relation to proposed licence modifications designed to give effect to the Authority's final determinations for the RIIO-ED2 licensees, published on 30 November 2022.

This document should not be taken to imply acquiescence or otherwise in the Authority's final determinations, or in any decision the Authority may ultimately take to proceed with its proposed modifications. Northern Powergrid has limited its response to the specific technical points of implementation of the final determinations which are contained in the statutory consultation.

### KEY POINTS

- A material misallocation of total cost allowances into Load Related Expenditure ("LRE") categories has occurred as a result of an error in Ofgem's process for apportioning Ofgem's view of total efficient costs between cost categories. This has the effect of allocating efficient cost allowances for other non-load activities, such as asset replacement and refurbishment, into the load rows in the Price Control Financial Model ("PCFM") (and all licence values) with the consequential impact of allocating too little into those other categories.
- A number of material issues remain unresolved and some new issues have been introduced in respect of the LRE conditions and the associated LRE Volume Drivers Governance Document (the "Volume Drivers Governance Document"), including that the RIIO-ED2 LRE "close-out" allowance adjustments are incomplete and unclear, the extent of the possible disallowance of volumes set out in the Volume Drivers Governance Document is much too broadly drafted, the scope of activities to be included within the volume driver remains unclear and the incorporation of flexibility services into special condition 3.9 is ambiguously implemented and contradicts some of the calculations in the RIIO-ED2 LRE Volume Drivers Workbook (the "Volume Drivers Workbook").
- Some of the above issues also interact with each other, creating larger issues.
- The net to gross adjustment for LRE should not be modified into the RIIO-ED2 licence. In any event, the net to gross adjustment basis in special condition 3.11 is ambiguously drafted and may disallow some legitimate adjustments as well as allowing Ofgem to make adjustments in inappropriate circumstances.
- Ofgem's definitions of New Transmission Capacity Charges and Transmission Connection Point Charges definitions have fundamentally changed the boundary between LRE and pass-through compared to RIIO-ED1.
- The Volume Drivers Governance Document confirms that the Volume Drivers Workbook forms part of the Volume Drivers Governance Document. This means that, as the Volume Drivers Governance Document is a licence instrument, the Volume Drivers Workbook is also a licence instrument. This should be made clear on the face of the licence.
- 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.

- There are inconsistencies in the application of Real Price Effects (“RPEs”) across a number of the allowance modification processes, relating to how RPEs are recognised in actual and forecast costs and in corresponding allowances.

# Representations by Northern Powergrid (Northeast) plc and Northern Powergrid (Yorkshire) plc in response to the notices of statutory consultation on proposals to modify the Special Conditions and the Standard Conditions of their electricity distribution licences, dated 14 December 2022

## Special Conditions ("SpC")

### **1. Allowance apportionment error in the Final Determinations ("FD")**

- 1.1. A material misallocation of total cost allowances into LRE categories has occurred as a result of an error in Ofgem's process for apportioning Ofgem's view of total efficient costs between cost categories. This has the effect of allocating efficient cost allowances for other non-load activities, such as asset replacement and refurbishment, into the load rows in the PCFM (and all licence values) with the consequential impact of allocating too little into those other categories.

### **2. Load Related Expenditure issues**

- 2.1. The quality of drafting of the LRE conditions and associated guidance documents has improved since the informal consultation. However, a number of material issues remain unresolved and some new issues have been introduced. Some of those issues also interact with each other, creating larger issues and meaning that the changes needed to resolve them are quite complex to enact. The issues are as follows:
  - a) The RIIO-ED2 LRE "close-out" allowance adjustments are incomplete and unclear;
  - b) The extent of the possible disallowance of volumes set out in the Volume Drivers Governance Document is much too broadly drafted and - at the extreme - could leave licensees ("DNOs") with no allowance at all;
  - c) The "check" to ex ante allowances to determine if volumes may be curtailed is not clearly defined in the Volume Drivers Governance Document, and contradicts the calculations in the Volume Drivers Workbook;
  - d) Difficulty identifying, confirming and documenting ex ante allowance values for load related activities;
  - e) The net to gross adjustment for LRE (SpC 3.11) should not be modified into the RIIO-ED2 licence;
  - f) The baseline percentage of Gross LRE expected to be delivered via Specific Customer Funded Reinforcement values set out in Appendix 1 of SpC 3.11 has been calculated on an inappropriate basis;

- g) The net to gross adjustment basis in special condition 3.11 is ambiguously drafted and may disallow some legitimate adjustments as well as allowing Ofgem to make adjustments in inappropriate circumstances;
  - h) Submission requirements include some aspects with which DNOs may be unable to comply and others that do not have any clear role in Ofgem's allowance setting process;
  - i) The legal status of documents/modifications has not been consistently implemented and the document hierarchy is unclear;
  - j) The scope of activities to be included within the volume driver remains unclear;
  - k) Incorporation of flexibility services into SpC 3.9 is ambiguously implemented, and contradicts some of the calculations in the Volume Drivers Workbook;
  - l) Important wording changes needed in the description of the circumstances under which a LRE Re-opener adjustment may be made;
  - m) Amendments to the various transmission connection point charges definitions have fundamentally changed the boundary between LRE and pass-through in a way that is not consistent with our understanding of Ofgem's policy; and
  - n) The scope of the review of the LRE Volume Drivers during R110-ED2 introduces regulatory uncertainty during the early years of the Price Control Period.
- 2.2. DNOs have had helpful initial discussions with Ofgem regarding these issues. We welcome that early engagement on these important issues and the fact that Ofgem has already acknowledged that it understands and agrees in principle with many of the issues.
- 2.3. We have set out detailed comments and drafting suggestions in Appendix 1.
- 2.4. Paragraph 2.17 of the Volume Drivers Governance Document confirms that the Volume Drivers Workbook forms part of the Volume Drivers Governance Document. This means that, as the Volume Drivers Governance Document is a licence instrument, the Volume Drivers Workbook is also a licence instrument. This should be made clear on the face of the licence. Consequently, SpC 3.9.9 should read:
- "The Load Related Expenditure Volume Drivers Governance Document, including the Load Related Expenditure Workbook, forms part of this condition."*
- We comment further regarding the Volume Drivers Workbook in Appendix 1.
- 2.5. SpC 3.2.77 requires the DNO, when making an application under the LRE re-opener, to set out in its application "any modifications to the outputs, delivery dates and allowances in Appendix 2 of Special Condition 3.3 being sought". Appendix 2 of SpC 3.3 should, therefore, be in a form that is consistent with other such appendices in the licence, as follows:

**Appendix 2****Evaluative Price Control Deliverables**

<b>Output</b>	<b>Delivery Date</b>	<b>Allowance (£m)</b>					
		2023/24	2024/25	2025/26	2026/27	2027/28	Total allowance (all years)
N/A	N/A	0	0	0	0	0	0

In addition, there is no Appendix 3 of Special Condition 3.3 in the licences of Northern Powergrid (Northeast) plc and Northern Powergrid (Yorkshire) plc such that the reference in SpC 3.2.80(b) to “Appendix 3 of Special Condition 3.3” is incorrect. SpC 3.2.80(b) should be changed to:

*“(b) modifications to the value of SINVT in Appendix 1 to Special Condition 3.3 and the outputs, delivery dates and allowances in Appendix 2 of Special Condition 3.3”.*

### **3. Transmission connection charges**

- 3.1. Ofgem’s definitions of “New Transmission Capacity Charges” and “Transmission Connection Point Charges” have fundamentally changed the boundary between pass-through and Load Related Expenditure compared to RIIO-ED1.
- 3.2. The current drafting time-limits the pass-through of Transmission Connection Point Charges because the definition now states that it is “for projects energised before 1 April 2023”. We believe that this is incorrect. Any such costs that are not New Transmission Capacity Charges - which should relate to assets energised from 1 April 2023 - should be Transmission Connection Point Charges. If, for example, NGET replaces an asset due to age/condition and energises that asset in RIIO-ED2, the definition of Transmission Connection Point Charges as currently written would prevent the licensee from passing-through the costs. This should not be the case.
- 3.3. Transmission Connection Point Charges should be passed-through unless the costs are captured by the definition of New Transmission Capacity Charges.
- 3.4. The current drafting has re-introduced a revised version of the defined term New Transmission Capacity Charges but it does not distinguish between those elements of Transmission Connection Point Charges that should be pass-through and those that should not. It is our understanding that Ofgem’s policy intent is to retain the concept that is currently in RIIO-ED1 of “Pass-through Transmission Connection Point Charges” and, therefore, by default the exclusion of New Transmission Capacity Charges on a direct pass-through basis. This policy position has not been given effect and a new policy distortion has been introduced.
- 3.5. In relation to the above comment, the definition of New Transmission Capacity Charges also requires amendment in line with policy intent and should not refer to “projects energised”

but needs to recognise that it refers to elements of Transmission Connection Point Charges only.

- 3.6. Changes are, therefore, required to the RIIO-ED2 defined terms to set the boundary between LRE and pass-through back to the RIIO-ED1 boundary. We have set out further comments and drafting suggestions in Appendix 1.

#### 4. Use of the term “manifest error”

- 4.1. 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 Volume Drivers 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”*.

- 4.2. SpC 3.9.14(e) only provides an example as to the meaning of “manifest error” i.e. *“discrepancies between the [Volume Drivers 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.

- 4.3. 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 irrebuttable presumption that the correction of a “manifest error” will have no impact on a DNO’s Allowed Revenue, that could only be potentially acceptable if the condition were to apply only to the correction of errors that the DNO 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 DNO’s Allowed Revenue.

- 4.4. 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.”*

- 4.5. 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”*.

- 4.6. 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).

- 4.7. 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”.*

## **5. Issues and inconsistencies for RPEs in various allowance modification processes**

- 5.1. 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 and have set out the issues and potential proposed solutions in Appendix 2.

## **6. 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**

- 6.1 We have set out the issues and potential proposed solutions in Appendix 3.

## **7. SpC 1.2: Definitions and references to Electricity Distributors**

- 7.1. Ofgem has confirmed that there is an error in the calculation of the values populated for each DNO in the definition of “Ex-ante Regulatory Equity”. These values need to be corrected.

- 7.2. A number of defined terms are not relevant to Northern Powergrid (Northeast) plc and Northern Powergrid (Yorkshire) plc as they relate to conditions marked “Not in Use”. Those terms should, therefore, be removed from SpC 1.2.4 in their licences, as follows:

- i) Decision on SHEPD’s Contribution to the Shetland Transmission Link;
- ii) Gas Distribution System;
- iii) Gas Transporter Licence;
- iv) Hebrides and Orkney Re-opener;
- v) LineSIGHT;
- vi) Moorside Nuclear Site;
- vii) Moorside Pre-Construction Funding;
- viii) New Control Room;
- ix) New Depot;
- x) Off-Gas Grid Customers;
- xi) Shetland Enduring Solution;
- xii) Shetland Enduring Solution Re-opener;
- xiii) Shetland Extension Fixed Energy Costs;
- xiv) Shetland Extension Fixed Energy Costs Re-opener;
- xv) Shetland Extension Variable Energy Costs;

- xvi) Shetland HVDC Link;
- xvii) Shetland Link Contribution;
- xviii) Shetland Transmission Link;
- xix) Smart Street; and
- xx) West Coast of Cumbria Re-opener.

## 8. SpC 1.3: Common Procedure

- 8.1. 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) A number of the processes are incompletely drafted and require expansion; and
- b) 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.

- 8.2. We have set out further comments and drafting suggestions in Appendix 4.

## 9. SpC 2.1: Revenue Restriction

- 9.1. In Part G (Forecasting penalty) of SpC 2.1, the BR (and BR\*) term essentially represent costs over which the DNO should have a relative degree of control as part of its Distribution Business and includes PT as a constituent part. However, PT contains Supplier of Last Resort (SoLR) costs which can be extremely material but cannot be categorised as being either controllable by the DNO and incurred as an activity of the Distribution Business. Further, and specific to the RRFP term, Bad Debt is also outside the reasonable control of the DNO (given that it is generally triggered by the same 'event' as that which results in the SoLR mechanism being activated) and, therefore, should be excluded from the assessment. Applying a forecasting penalty to this element of Allowed Revenue is inappropriate and, on our understanding that Ofgem would waive penalty adjustments associated with these amounts, should be excluded from the assessment to prevent an unnecessary request and consent process - or a need for Ofgem to direct that the BRFP and/or RRFP terms are a value other than one or zero (i.e. as a proxy for exempting amounts in the total variance that are explicitly outside of a DNO's reasonable control).
- 9.2. The issue can be addressed for the BRFP term either by creating a new term that is PT less SoLR (i.e. the SLR term in SpC 6.1) or by explicitly deducting SLR from BR (and BR\*). The issue can be addressed for the RRFP term by explicitly stating that Recovered Revenue is not net of Bad Debt for this purpose.



## 10. SpC 2.3: Return Adjustment

- 10.1. SpC 2.3.4 allows the Authority an indeterminate period of time after the Price Control Period ends to undertake the review of Operational Performance. It remains wholly inappropriate for DNOs to not have a clear understanding of when the Authority is likely to reach a decision on such a potentially material issue. The review should be completed in conjunction with the Annual Iteration Process in 2028 and the relevant date should, therefore, be inserted into SpC 2.3.4.
- 10.2. “Operational Performance” is currently defined as including “output delivery incentive performance”, which is not defined. The algebra set out in SpC 2.3.7 uses the term “OPP” which is defined by reference to the value for Operational Performance calculated in the ED2 PCFM. The ED2 PCFM does not include payments made in relation to severe weather and normal weather guaranteed standards within IIS output delivery incentive revenue but does include any “true-ups”. It is, therefore, not capturing a complete picture of operational RORE performance in this area and could be missing a material value given the level of overall RORE caps set in relation to guaranteed standards payments in SpC 4.4.
- 10.3. In addition, use of “baseline” in reference to allowed return on equity is confusing and could (incorrectly) imply the exclusion of updates to the allowed cost of equity during ED2 arising from indexation of the risk-free rate.
- 10.4. The word “baseline” should be deleted from the definition of “Operational Performance” and the definition should include all guaranteed standards payments made in relation to severe weather and normal weather such that the definition reads:

*“Operational Performance is a measure of returns which includes totex and output delivery incentive performance, including payments made under regulations 5 and 7 of the Electricity (Standards of Performance) Regulations 2015, but excludes performance on debt, tax, and the business plan incentive. It also excludes the allowed return on equity.”*

## 11. SpC 3.1: Allowed Network Asset Risk Metric (“NARMS”) expenditure – sign transposition

- 11.1. 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.
- 11.2. 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 in Appendix 5.

**12. SpC 3.3: Evaluative Price Control Deliverables**

- 12.1. In response to the informal consultation we commented that the process for the assessment of evaluative Price Control Deliverables (“PCDs”) is a generic process, some aspects of that generic process are not appropriate for the assessment of cyber PCDs, the generic drafting of key defined terms (such as Consumer Outcome, Efficiency and Innovation) makes it difficult for DNOs to understand how cyber PCDs will be assessed or the likely impact on future allowance modifications and those key terms should be reviewed and better tailored to the assessment of cyber PCDs. Ofgem’s response in the issues log referred to hypothetical examples documented in the “RIIO-2 Cyber Resilience OT and IT PCD Reporting Guidance”. The issues raised should be addressed on the face of the licence and not in a guidance document.
- 12.2. Ofgem confirmed in the issues log that the implementation of any future Strategic Investment PCD will follow a modification process under S11A of the Electricity Act 1989 but no changes to the licence are needed to clarify that. We believe that such a reference on the face of the licence is necessary, consistent with other conditions such as the LRE Re-opener and the Net Zero Re-opener.
- 12.3. Please also see our comments below about the inclusion of references to a “Use It or Lose It” (“UIOLI”) mechanism regarding Cyber resilience in Appendix 4 of the RIIO-2 Price Control Deliverables Reporting Requirements and Methodology Document (“Appendix 4”), which introduce adjustments that conflict with SpC 3.3.

**13. Incorporation of flexibility services into SpC 3.9 is ambiguously implemented and contradicts some of the calculations in the Volume Drivers Workbook**

- 13.1 It is a view common to all DNOs that, as set out in section 11 of Appendix 1, the allowance calculations to incorporate flexibility services into the volume driver are not clearly written, are contradictory between SpC 3.9 and the Volume Drivers Workbook and can be subject to different interpretations such that consequential changes should be made to SpC 3.9.
- 13.2 It is Northern Powergrid’s own view that the drafting and algebraic changes set out in Appendix 6 could achieve the intent that Ofgem described during the load policy meeting on 10 January 2023.

**14. SpC 3.11: Net to gross adjustment for Load Related Expenditure**

- 14.1. The net to gross adjustment for LRE should not be modified into the RIIO-ED2 licence. In any event, the net to gross adjustment basis in special condition 3.11 is ambiguously drafted and may disallow some legitimate adjustments as well as allowing Ofgem to make adjustments in inappropriate circumstances.
- 14.2. We have the following comments, in the event that the Authority decides to retain SpC 3.11 and have set out further comments and drafting suggestions in Appendix 1.

- 14.3. SpC 3.11.9 allows the Authority an indeterminate period of time after the Price Control Period ends to modify the value of  $NGLRE_t$ . It remains wholly inappropriate for DNOs to not have a clear understanding of when the Authority is likely to reach a decision on such a potentially material issue. The modification should be made in conjunction with the Annual Iteration Process in 2028 and the relevant date should, therefore, be inserted into SpC 3.11.9.
- 14.4. The baseline percentages in Appendix 1 to SpC 3.11 have been based on the forecast submitted by the DNO but the calculation does not take account of the fact that Ofgem has normalised all DNOs' business plans back to system transformation. Ofgem should, therefore, review its calculation of the baseline percentages to ensure they are consistent for all DNOs.

## 15. SpC 4.4: Interruptions incentive scheme output delivery incentive

- 15.1. There are currently provisions in CRC2D.33 and CRC2D.36 whereby protection is given to the DNO in a scenario where the Authority has been unable to make a determination in respect of a severe weather event claim or an other exceptional event claim by the time required for it to be processed through the Annual Iteration Process. It remains inappropriate for DNOs to not have a clear understanding of when the Authority is likely to reach a decision on such potentially material issues.
- 15.2. Insert provisions into Part G and Part H of SpC 4.4 that are similar to those currently in CRC2D.33 and CRC2D.36 i.e. *"If the Authority has neither directed the licensee under paragraph XX nor otherwise notified the licensee of its conclusions with respect to the matter within six months of the submission date of the annual interruptions data for the relevant Regulatory Year, the performance adjustment to which paragraph XX refers will be deemed to have been made."*
- 15.3. The appendices to SpC 4.4 should be updated with the latest figures (after incorporation of the latest year's performance data in the calculations).

## 16. SpC 6.1: Pass through items

- 16.1. The definition of the SLR term in SpC 6.1.3 refers to the "aggregate Specified Amount of the Valid Claims requiring payment". The use of "Specified Amount" is, however, not appropriate in this context. This is because, for example, a Valid Claim that is received in December 2022 that does not breach the Materiality Threshold will be paid between March 2023 and February 2024 i.e. one instalment in 2022/23 and the remainder in 2023/24. The instalment paid in 2022/23 will be recovered via SpC 7.5 in 2024/25 and will also be recovered in 2023/24 via the SLR term as it will be included in the "Specified Amount" of the same Valid Claims that will be paid in 2023/24, even though not all of the "Specified Amount" will be paid in that period.

- 16.2. As Ofgem has not made other changes that we proposed previously and to ensure that there is no duplication of SoLR cost recovery, "Specified Amount" should be replaced with "amount" such that the definition of the SLR term is changed to:

*"SLR<sub>t</sub> means the aggregate amount of Valid Claims requiring payment in accordance with the licensee's obligations under Standard Condition 38B (Last Resort Supply: Payment Claims)"*

- 16.3. The definition of EDE<sub>t</sub> in SpC 6.1.3 should not include the word payment, as this implies passing through payments actually made in the Regulatory Year, which is not the case. The definition of EDE<sub>t</sub> should read:

*"EDE<sub>t</sub> means the payments in relation to the Pension Scheme Established Deficit repair expenditure, as set in the triennial review of Pension Scheme Established Deficit provided for in the ED2 Price Control Financial Handbook; and"*

## **17. SpC 7.5: Legacy pass-through items term**

- 17.1. In the RIIO-ED1 licence, SoLR costs are categorised in two separate terms: (i) SLRA, which represents a Valid Claim that has not resulted in the Materiality Threshold set out in SLC38B being breached; and (ii) ESA, which represents a Valid Claim that has breached the Materiality Threshold. A Valid Claim subject to SLRA treatment is recovered two years after it is paid e.g. any costs impacting 2022/23 will be recoverable in 2024/25. However, any Valid Claim submitted before 31 December 2022, which breaches the Materiality Threshold, will be recoverable in 2023/24 via the ESA term.
- 17.2. Ofgem did not previously include a legacy ESA term in the RIIO-ED2 licence because the SLR term in SpC 6.1.3 removes the need for it given that it captures payment of a Valid Claim in 2023/24, which any outstanding Valid Claim from RIIO-ED1 would not impact sooner than. Therefore and as verbally agreed with Ofgem, the treatment of SoLR costs between SpC 6.1 and SpC 7.5, as set out in the informal consultation, captures all Valid Claims that a DNO will be required to pay and in respect of which it has not yet commenced recovery.
- 17.3. Consequently, the use of the ESA term in SpC 7.5 would result in allowances equivalent to double the 2023/24 ESA and would be in addition to the above-noted double-recovery of the March 2023 SLRA payments under SpC 6.1, as it is currently drafted. The ESA term and its associated definition should, therefore, be removed from SpC 7.5.

## **18. SpC 8.1: Governance of the ED2 Price Control Financial Instruments**

- 18.1. Consistent with our comments regarding SpC 3.9, it should be made clear that the presumption in SpC 8.1.4 is rebuttable by the addition of *"(unless the licensee shows otherwise)"* such that SpC 8.1.4 reads:

*“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”.*

## 19. Other comments

- 19.1. We have made further comments regarding the Special Conditions that are generally of a clarificatory or presentational nature in the “Special Conditions Issues Log” provided with this response.

## Price Control Financial Model

### 20. DNO input worksheets (row 288)

- 20.1. The tax trigger deadband values are incorrect. This is a fixed input which has not been updated since Draft Determinations and is calculated incorrectly because it is based on 0.33% of base revenue, rather than the effect of a 1% change in the rate of corporation tax (which is greater). The value should be calculated as *“the greater of 0.33% of opening base revenue allowances and the effect of a 1% change in the rate of corporation tax”* (FD Finance Annex paragraphs 7.40 and 7.48) The opening base revenue used in this calculation should include the equity issuance allowance (FD Finance Annex para 7.48). As an example, we calculate that correction of this error will increase the annual average deadband values by £0.4m for Northern Powergrid (Northeast) plc and £0.5m for Northern Powergrid (Yorkshire) plc.
- 20.2. The tax trigger deadband values should be recalculated. As these values will be fixed for the whole of the price control period, they should be included as fixed values in the PCFM or in licence (consistent with other thresholds and fixed values

## Price Control Financial Handbook

### 21. Table 3.1

- 21.1. In line with our comments regarding removal of the ESA term from SpC 7.5, the ESA term should also be deleted from the legacy variable values table.

### 22. Paragraph 6.3(d)

- 22.1. It is our understanding that DNOs will be able to update the capital allowances allocation rates during ED2 but this is not clear from the text. In order to clarify, *“These can be revised through ... ”* should be changed to *“These can be revised by licensees through ... ”*
- 22.2. There is only one term for TPA for totex capital allowances allocation rates, but there are 42 separate categories, which means that the value associated with the TPA term is not clear. It should be made clearer in the text that the term refers to multiple input rows to be updated by DNOs.

**23. Chapter 8: Legacy Adjustments**

- 23.1. The Streetworks ED1 close-out adjustment is missing from Table 8.3 (Closeout adjustments in the ED1 Legacy PCFM) and so should be included in that table as follows:

Closeout methodology	Relevant ED1 licence reference	ED1 Legacy PCFM input adjusted	Basis for profiling adjustments	Direction Timing
Section 5: Specified Street Works Costs	CRC 3F.20	UCSSW	Timing profile of incurred expenditure	By 30 November 2024

The following Sections should be re-numbered accordingly.

**Volume Drivers Governance Document****24. Paragraph 2.13**

- 24.1. We do not believe that it is appropriate to include this paragraph in the Volume Drivers Governance Document because the obligations are included in other licence conditions and the Distribution code. Paragraph 2.13 should be deleted.

**25. Paragraph 2.54**

- 25.1. The expectation included in this paragraph is already subject to the Data Best Practice Guidance, as recognised by the paragraph. Consequently, it is not appropriate to include paragraph 2.54 in the Volume Drivers Governance Document and it should be deleted.

**26. Paragraph 5.5**

- 26.1. There appears to be a drafting error in paragraph 5.5 of the Volume Drivers Governance Document. As presently drafted, paragraph 5.5 leaves open the possibility of important changes (e.g. to allowed revenue calculated in accordance with the volume drivers) being made by direction rather than by licence modification, as long as these changes do not take place by way of modification of SpC 3.2.9 or change to the Volume Drivers Governance Document itself.
- 26.2. This must be a drafting error given that the operation of the volume drivers is now a matter of licence condition (SpC 3.9.9) and that changes must be made by way of statutory licence modification, unless they fall within the categories specified exhaustively in the licence (SpC 3.9.12).
- 26.3. Consequently, paragraph 5.5 should refer also to any disallowance of revenue under paragraph 4.5, confirming that this too would require licence modification such that it reads:

*“If, as a result of the review, the Authority identifies changes required to be made under this Governance Document, including any disallowance of revenue under paragraph 4.5, or to either SpC 3.9 or this Governance Document, it will make those changes following the statutory modification process set out in S11A of the Electricity Act 1989. Where changes to the RIGs or RRP are identified as a result of the review, those changes will be made in accordance with Standard Licence Condition 46.”*

## **27. Appendix 1**

- 27.1. Although the unit costs and industry benchmark values have been included in the Volume Drivers Workbook (Appendix 1 to the Volume Drivers Governance Document) and so were provided as part of the statutory consultation, DNO-specific data e.g. the specific ex ante and volume driver cap values were not provided so DNOs have not had the opportunity to review that data.
- 27.2. As the Volume Drivers Workbook forms part of SpC 3.9, this means that the DNO-specific data was not included in the statutory consultation. Ofgem should, therefore, correct that position without delay.

## **28. Other comments**

- 28.1. We have made further comments regarding the Licence Instruments that are generally of a clarificatory or presentational nature in the “Licence Instruments Issues Log” provided with this response.

## **Standard Conditions (“SLC”)**

### **1. SLC 10AA: Treating Domestic Customers Fairly**

- 1.1. The RIIO-ED2 Fair Treatment Guidance is not issued under SpC 1.3. Consequently, the process set out in SLC 10AA.7 should be consistent with that for other documents issued under the standard conditions and should read:

*“The Authority will issue and amend the RIIO-ED2 Fair Treatment Guidance by direction. Before issuing or amending the RIIO-ED2 Fair Treatment Guidance the must send to all licensees in whose licence this condition has effect and publish on the Authority’s website:*

- (a) the text of the new or amended RIIO-ED2 Fair Treatment Guidance;*
- (b) the date on which the Authority intends the new or amended RIIO-ED2 Fair Treatment Guidance to come into effect;*
- (c) the reasons for the new or amended RIIO-ED2 Fair Treatment Guidance; and*
- (d) a period during which representations may be made on the content of the new or amended RIIO-ED2 Fair Treatment Guidance, which may not be less than 28 days from the date of the Notice.”*

- 1.2. New paragraphs SLC 10AA.8 and SLC 10AA.9 should be inserted as follows:

**New SLC 10AA.8:**

*“The Authority must:*

- (a) publish the RIIO-ED2 Fair Treatment Guidance on the Authority’s website; and*
- (b) ensure that any amendments to the RIIO-ED2 Fair Treatment Guidance are promptly incorporated into a consolidated version maintained on the Authority’s website.”*

**New SLC 10AA.9:**

*“The steps required to issue or amend the RIIO-ED2 Fair Treatment Guidance may be satisfied by action taken before, as well as by action taken on or after 1 April 2023.”*

- 1.3. Current paragraph SLC 10AA.8 should be re-numbered SLC 10AA.10.
- 1.4. The definitions of “Domestic Customer”, “Priority Services Register Customers” and “Representative” should be deleted because those definitions are already in SLC 1.

**2. General formatting issues**

- 2.1. There are formatting issues in various places in the document that need to be addressed such as missing paragraph numbers, incorrect bullet point numbers, inconsistency of font size and type and incorrect alignment.

**3. Other comments**

- 3.1. We have made further comments regarding the standard conditions that are generally of a clarificatory or presentational nature in the “Standard Conditions Issues Log” provided with this response.



**Appendix 1****Material issues in the statutory consultation version of the LRE and Net to Gross conditions and the associated Volume Drivers Governance Document**

This Appendix focusses on drafting issues or areas where the policy is unclear with implications for drafting clarity where all DNOs are in agreement. It does not cover aspects of policy with which DNOs may disagree or individual DNO points. To assist Ofgem in identifying any DNO-specific issues, DNOs have developed a common issues log that captures the commonly agreed issues. Any issues that are not commonly agreed are identified separately in DNO's individual issues logs.

**1. RIIO-ED2 load "closeout" LRE allowance adjustments are incomplete and unclear****Issue(s):**

All DNOs agree that the net to gross adjustment for LRE should not be modified into the RIIO-ED2 licence. Additionally, some DNOs have concerns with other aspects of Ofgem's policy approach to RIIO-ED2 load closeout that they will respond on separately.

Without prejudice to those policy concerns, the adjustments to LRE allowances that are to be made at the end of RIIO-ED2 are incomplete, inconsistently drafted and do not appropriately acknowledge the potential interactions between the various adjustments:

- a) The adjustment to be made to LRE allowances at the end of RIIO-ED2 if a DNO has spent less than 80% of FD allowances (referred to in FD core para 3.18) has not been incorporated into the licence at all.
- b) The adjustment to flexibility services allowances is only briefly documented in the Volume Drivers Governance Document (para 2.14) and is not referred to in SpC 3.9 itself. The drafting of this adjustment also fails to recognise that, provided that the reduced expenditure on flexibility services arises due to lower than anticipated volumes, the volume driver mechanism will have already operated to remove the associated allowances. The adjustment also operates based on spend rather than re-calculated allowances and seems to have the effect of removing any outperformance or under performance that would otherwise have been taken account of via the Totex Incentive Mechanism ("TIM").
- c) The end of period net to gross adjustment under SpC 3.11 is unable to take account of the two other end-of-period adjustments to LRE allowances (3.11.9).

**Consequence:**

The gaps in and wording of existing drafting leads to a lack of clarity of the intended allowance adjustments that may be made at the end of RIIO-ED2.

At present, therefore, there is significant potential for these adjustments to double count each other or to double count the adjustments made mid-RIIO-ED2 via the volume driver or re-opener mechanisms.

This makes it difficult for DNOs to reasonably foresee how the conditions will operate and revenue will be affected.

It is also not possible for DNOs to predict the associated allowance changes when setting use of system charges for Regulatory Years within RIIO-ED2.

**Fix:**

The end of period allowance adjustments all need to be drafted in a way that (a) include all relevant adjustments; (b) explain how the various end of period calculations interact with each other; and (c) also take account of allowance adjustments that have already been made during the course of RIIO-ED2.

This may be easier to achieve by incorporating all end of period adjustments into one RIIO-ED2 load closeout licence condition.

**Some specifics:**

- a) The adjustment to be made to LRE allowances at the end of RIIO-ED2 if a DNO has spent less than 80% of FD allowances (FD core para 3.18) needs to be incorporated into the licence. While the specific details of the assessment may be subject to a close-out consultation, the licence should recognise that 80% of allowances is a trigger for an assessment of a potential adjustment. Without such visibility DNOs have no reference for what value of expenditure would attract an adjustment:
  - i) The inclusion of such an adjustment would be consistent with the approach taken during the modification of the RIIO-ED1 licence by the inclusion of potential end of Price Control Period adjustments in CRC3G;
  - ii) Some of the drafting and algebra in CRC3G could be used in drafting an equivalent adjustment for RIIO-ED2; and
  - iii) This adjustment should be very clearly constrained to the ex ante funding provided for the sub-set of LRE that matches the scope of the LRE Re-opener i.e. it does not apply to ex ante allowances for flexibility services or any other activities that fall within the scope of the volume drivers.
- b) The end of period adjustment for flexibility services needs further thought:
  - i) If the intent is to true-up for the actual volumes and nature of flexibility service contracts delivered during RIIO-ED2, the volume driver (as drafted in the statutory consultation) will already achieve this. In that case no further adjustment is required.
  - ii) If the intent is to somehow true up for actual spend, care needs to be given to both the incentive properties of such an approach and the associated drafting. If such an

adjustment is required, it must be documented in the special condition, in order to avoid any apparent conflict between the condition and the guidance.

- iii) Note that this issue interacts with the issues set out in section 9 (the operation of the volume driver for flexibility services during RIIO-ED2).

The drafting of the net to gross condition needs to clearly show how the adjustments in SpC 3.11 will be calculated in a way that avoids double counting the other RIIO-ED2 closeout adjustments.

**2. The extent of the possible disallowance of volumes set out in the Volume Drivers Governance Document is much too broadly drafted and - at the extreme - could leave DNOs with no allowance at all**

**Issue(s):**

Paragraph 4.5 of the Volume Drivers Governance Document allows Ofgem to move to step 2 in the process where Ofgem then has to decide whether or not to disallow all volumes within a particular volume driver if one metric has been failed and the resultant allowances exceed those at FD. As written, this would allow Ofgem to remove all volumes, including those assumed at FD. It should be clear that only volumes and the resultant expenditure above the ex ante allowance within the relevant volume driver may be disallowed and the Volume Drivers Governance Document should set out in much clearer detail what Ofgem will take into account when determining the number of volumes to be disallowed.

The same paragraph also talks about Ofgem “withholding expenditure”, whereas we assume that Ofgem would disallow some volumes from being included in the volume driver calculations in this circumstance (i.e. Ofgem would adjust totex allowances rather than somehow amending the level of actual expenditure that would flow through to actual totex in the PCFM).

At the moment, if the DNO has spent more than its FD ex ante allowances, as soon as one metric is failed it seems that all volume driver allowances (for the variable value in question) can be removed (4.3, 4.5).

**Consequence:**

The mechanism in paragraph 4.5 of the Volume Drivers Governance Document noted above permits Ofgem to disallow all volumes associated with one of the load volume drivers, even if only one metric is slightly into “fail” and if expenditure exceeds that provided in the baseline. Because the volume driver overwrites in the PCFM, this allows Ofgem to remove all volumes, including those assumed at FD, leaving a DNO with no allowance. It is, therefore, important that the process that Ofgem must follow when determining any disallowances is clearly defined and that adjustments are appropriately constrained. For example, it is currently unclear how Ofgem will separate expenditure linked to volumes that are efficient and have passed metrics, from expenditure associated with from volumes that have failed a metric.

The extent of this adjustment could be far greater than is needed to return the DNO to the level of allowance assumed at FD, or to remove sufficient volumes to return the relevant metric to “pass” status.

**Fix:**

The process that Ofgem will follow/things it would consider when disallowing any volumes should be explained in much clearer detail in order to more appropriately constrain the quantum of disallowed volumes.

As no adjustments are made if the DNO is within its ex ante allowances it would seem logical for any volume disallowance to be limited to returning the DNO to its ex ante allowance. Similarly, as no adjustments are made if the DNO is within the defined tolerance of the metric, it would seem logical that the extent of any adjustment goes no further than returning the DNO to a position where the metric is within the defined tolerance.

In addition to the text in 4.5 setting out that adjustments can only be made if “the Authority is not satisfied that the expenditure above the ex ante allowance was justified”, the following further constraints to the extent of adjustments should be included:

- a) The scope of any adjustment should be constrained to the sub-set of activities that the metric is designed to test. It would help to include a simple mapping table showing which metrics relate to which volume driver “activities”. (i.e. similar to the table shared on slide 5 of Ofgem’s deck from the load policy meeting of 7 December 2022). For example, it is illogical for the transformer metrics to adjust allowances for circuit work.
- b) The extent of any volume disallowance should be constrained to be no greater than the smaller of:
  - i) The quantum required to return the DNO’s allowances to its original ex ante allowances at FD for the activities measured by the metric that has “failed”; and
  - ii) The quantum needed to return the metric in question to a “pass” status.

**3. The “check” to ex ante allowances to determine if volumes may be curtailed is not clearly defined in the Volume Drivers Governance Document and contradicts the calculations in the Volume Drivers Workbook**

**Issue(s):**

The “check” to ex ante allowances to determine if volumes may be curtailed is not clearly defined in the Volume Drivers Governance Document. For example:

- a) The “ex ante allowances” that must be exceeded is inconsistently named in the Volume Drivers Governance Document but does not make it clear that it is the 5 year allowance at FD (excluding RPEs). It could be interpreted as an annual allowance amount.

- b) It is unclear what activities are to be included in the “ex ante allowances” i.e. the level of disaggregation at which the comparison is undertaken:
  - i) 2.24 could be read to suggest that only the allowances relevant to the metric that has been failed will be considered;
  - ii) 4.2 simply refers to “ex ante allowances”, which could be interpreted as broadly as full LRE allowances or even full totex allowances; and
  - iii) The Volume Drivers Workbook suggests that the comparison to be undertaken is to be based on all activities within the volume driver in question.
- c) The description of the cumulative adjusted “costs” that are to be compared to the 5 year FD allowance refers to “efficient unit rates”. We assume that the intended comparator is adjusted allowances based on actual volumes (minus any that have been previously disallowed) multiplied by the relevant unit cost in SpC 3.9, but this is not clear in the way the guidance has been drafted.

In general, we think this calculation is more clearly set out in the Volume Drivers Workbook (although the lack of populated allowance values means that we cannot be certain).

**Consequence:**

This key calculation is unclear. Different interpretations of the required calculation could lead to volume adjustments being applied in very different scenarios.

As the Volume Drivers Governance Document conflicts with the Volume Drivers Workbook, it is unclear what status the calculation in the Volume Drivers Workbook has in this regard.

**Fix:**

There are two broad options available here:

- a) Make changes to improve the clarity of drafting of the “check” to ex ante allowances in the Volume Drivers Governance Document (see specifics below); or
- b) Refer in the Volume Drivers Governance Document to the relevant calculations in the Volume Drivers Workbook, and remove specifics from the Volume Drivers Governance Document (using the same approach to cross referencing that is used to refer from PCFH to PCFM).

If the comparison is to be retained in the Volume Drivers Governance Document, we recommend that defined terms are created to cover:

- The relevant ex ante allowances:
  - i) 5 year values.

- ii) Excluding RPEs.
- The adjusted allowances that they are to be compared to:
  - i) Cumulative adjusted allowances for RIIO-ED2 years to date, based on actual volumes (minus any that have been previously disallowed) x unit costs in SpC 3.9, excluding associated RPEs.

The Volume Drivers Governance Document would need to set out the scope/level of disaggregation at which the comparison is undertaken.

#### **4. Difficulty identifying, confirming and documenting ex ante allowance values for load related activities**

DNOs cannot identify all relevant ex ante allowances in FD files.

##### **Issue:**

In general, DNOs are finding it difficult to identify the ex ante allowances that will be used in a number of the “tests” and calculations in the various load related licence conditions.

##### **Consequence:**

DNOs cannot confirm the values that will apply for their DNOs during RIIO-ED2.

Differences of view may arise when we come to use these mechanisms and “tests” during or at the close-out of the Price Control Period.

##### **Fix:**

Please provide DNOs with details of the relevant ex ante allowance values for all the various LRE components for review prior to modification notices being issued.

The annual and 5 year ex ante allowance values for all relevant components of LRE must be clearly set out on the face of a document with an appropriate legal status. (Note that the values in the PCFM will be over-written annually and cannot be used for this purpose).

The Volume Drivers Workbook must be populated with fixed DNO-specific data prior to modification notices being issued.

##### **Issue:**

The version of the Volume Drivers Workbook that was issued for the statutory consultation has not been populated with important, fixed DNO-specific data. For example, it has not been populated with the ex ante allowances which are required to determine whether any failed metrics may result in volumes being disallowed.

**Consequence:**

DNOs have been unable to review the version of the Volume Drivers Workbook that will ultimately be used to set allowances, to check that they agree with the values included within it or to check the operation of the Volume Drivers Workbook with relevant values populated.

**Fix:**

Provide a copy of the Volume Drivers Workbook that has been populated with individual DNO data so that each DNO can check its intended operation prior to modification notices being issued.

The ex ante allowances for activities that fall within the scope of the Load Related Re-opener need to be set out on the face of the licence.

**Issue:**

Sub-paragraph 3.2.75(c) sets out that one of the criteria that must be satisfied for a LRE Re-opener application to be made is that the increase in LRE “is not provided for by ex ante allowances”.

The value of those ex ante allowances is not set out on the face of the licence. It is also not possible to infer the value of those ex ante allowances from any of the other licence documents. In particular, the assumed inclusion of flexibility services ex ante allowances within “non-variant allowed load related capex” means that the values populated in the PCFM cannot be used for this purpose.

**Consequence:**

The DNOs have no visibility of the relevant values that must be considered when demonstrating that the “test” in 3.2.75(c) has been met or proposing the required values of  $LRE_t$  required by paragraph 3.2.77(f).

**Fix:**

We suggest that a new appendix to SpC 3.2 be created for this purpose, with a cross reference to that new appendix provided in paragraph 3.2.75(c)(i).

The appendix would need to provide an annual allowance for each DNO, in order that DNOs can meet the requirement in 3.2.77(f) to provide an annual profile for the proposed  $LRE_t$  allowances.

Also, in order to access the re-opener the DNO must be able to show that its costs have, or will, increase relative to the:

- a) Planning scenario used by Ofgem to set ex-ante allowances (3.2.75(a)(i));
- b) Access SCR assumptions used by Ofgem to set ex-ante allowance (3.2.75(a)(ii)); or
- c) Conditions on the system assumptions used by Ofgem to set ex-ante allowances (3.2.75(b)).

Consequently, Ofgem needs to specify what its assumptions were for the baseline.

**5. The net to gross adjustment for LRE (SpC 3.11) should not be modified into the RIIO-ED2 licence**

The need for the net to gross adjustment for LRE (SpC 3.11) has neither been justified nor subject to policy consultation.

In Ofgem's "reasons and effects" document, Ofgem sets out that its reason for including the condition is "to improve the structure and clarity of the licence and ensure it is coherent with the new uncertainty mechanisms introduced for Load Related Expenditure". However, the condition does not achieve the effect that Ofgem says it will achieve:

- a) SpC 3.11 does not improve the clarity of the licence. The basis of any adjustment to be made under this condition is unspecified and acknowledged by Ofgem to be unclear. In its issues log Ofgem is clear that "it may be very difficult to know exactly how that change would be made". Such a lack of certainty regarding the adjustments that could be made under this condition cannot improve the clarity of the licence.
- b) It also does not ensure that it is coherent with the new uncertainty mechanisms. Throughout the evolution of the LRE toolkit via working groups, this mechanism has not been part of policy discussions or proposals and has not been part of policy consultations. As a result, the logic for keeping it is unclear. Furthermore, the condition is not drafted in a way that explains how this mechanism will interact with other load "closeout" mechanisms that will operate at the end of the Price Control Period.

LRE policy has undergone a significant overhaul to ensure that DNOs can enable net zero by having sufficient funding to invest, whilst protecting customers. However, this consultation seeks to introduce broadly the same mechanism as in RIIO-ED1, without fully considering the interactions with the new LRE mechanisms or the implications of Access SCR.

We believe that Ofgem has given itself all the tools that it needs to adjust LRE allowances for likely changes in the drivers of LRE during the Price Control Period in the other tools within its toolkit of uncertainty mechanisms, namely the LRE Re-opener and the LRE volume drivers.

This toolkit of regulatory mechanisms segments expenditure down into different categories depending on the type of expenditure, each with safeguards for customers to ensure optimal investment. These safeguards include:

- a) Ex-ante allowances set by stringent benchmarking accompanied by a downward adjustment of volumes using the lowest net zero compliant scenario, putting LRE allowances at lowest credible value and all networks on a common basis;
- b) Closeout assessment if DNOs have not spent more than 80% of their non-volume driver LRE ex-ante allowances;
- c) Volume drivers in place for secondary network and LV services, accompanied by a licence status governance document which includes 6 check metrics and criteria for which investment needs to meet;



- d) Maximum revenue caps on volume driver expenditure;
- e) Review of volume driver operation at year 3;
- f) Discrete ex ante and variant allowance for flexibility services procurement, with any unspent ex ante allowances returned to customers in full at the end of the period; and
- g) Use of Price Control Deliverables for Strategic Investment projects.

The proposed net to gross adjustment for LRE also fails to fully consider the implications of Access SCR. Within DCP404, DCUSA defines the objective of the Access SCR, with a key deliverable being: “The overall connection charge faced by those connecting to the distribution network will be reduced removing the contribution to wider network reinforcement costs for demand connections and reducing it for generation connections”. The extensive work that has been undertaken in agreeing the conditions and charging arrangements of the Access SCR will provide sufficient protection for customers wanting to connect onto the distribution network.

Access SCR will have a fundamental impact on net to gross percentages. It is well understood that future customer contributions from 1 April 2023 will be minimal. Any contributions required will be based upon recently revised connection charging arrangements implementing the Ofgem’s Access SCR decision.

As a result of the extensive customer protections Ofgem has implemented within its toolkit of LRE mechanisms, and the changes to Access SCR, the fact that the introduction of SpC3.11 neither adds clarity to the licence nor takes into account interactions with the other mechanisms and the planned close-out assessments means that the net to gross adjustment for LRE condition (SpC 3.11) is unnecessary and should be removed from the RIIO-ED2 licence.

**6. The baseline percentage of Gross Load Related Expenditure expected to be delivered via Specific Customer Funded Reinforcement values set out in Appendix 1 of SpC 3.11 has been calculated on an inappropriate basis**

Without prejudice to DNOs’ view that the net to gross adjustment for LRE (SpC 3.11) should not be modified into the RIIO-ED2 licence, we note the following fundamental issue with the basis on which the key value against which the condition is intended to operate has been calculated.

**Issue:**

We understand from correspondence with Ofgem that the values populated in Appendix 1 of SpC 3.11 for the baseline percentage of Gross LRE expected to be delivered via Specific Customer Funded Reinforcement have been populated based on DNOs’ submitted plans.

Ofgem has made a number of very significant changes to DNOs’ submitted plans in determining ex ante allowances for LRE activities. Most notably:

- a) normalising plans to Ofgem’s chosen System Transformation planning scenario; and

- b) making adjustments to allowances to reflect the outcome of the Access SCR for the first two years of RIIO-ED2.

Both of these changes will change the proportion of Gross LRE that is expected to be delivered via Specific Customer Funded Reinforcement.

These fundamental changes have not been reflected in the central value against which the condition is intended to operate. This means that the condition is currently drafted to operate against adjustment thresholds that are internally inconsistent with the basis on which LRE allowances have been set.

DNOs do not have details of the equivalent values that would be consistent with the way in which LRE allowances have been set. These cannot 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.

**Consequence:**

The basis on which the baseline percentages have been calculated has the effect of proposing allowance adjustments in circumstances that are inconsistent with the way in which allowances have been set. This has the effect of creating an asymmetrical adjustment mechanism (because the baseline percentages are not consistent with the outcome assumed in setting ex ante allowances) creating the risk of an inappropriate reporting burden and inappropriate allowance adjustments.

DNOs do not have the data to calculate the materiality of the difference, but – based on the extent of changes required to normalise plans to System Transformation and to incorporate changes to reflect the outcome of the Access SCR - believe that the difference is likely to be material.

**Fix:**

If SpC 3.11 is to be modified into the licence, the baseline percentage of Gross LRE expected to be delivered via Specific Customer Funded Reinforcement in Appendix 1 of SpC 3.11, along with the Specific Customer Funded Reinforcement Percentage Band that is calculated relative to that percentage, must be populated with values that are internally consistent with the assumptions made in setting ex ante allowances for LRE.

Furthermore, DNOs must be provided with the Gross LRE and Specific Customer Funded Reinforcement values that are assumed in the calculation of the baseline percentage of Gross LRE expected to be delivered via Specific Customer Funded Reinforcement.

**7. Net to gross condition adjustment basis is ambiguously drafted and may disallow some legitimate adjustments as well as allowing Ofgem to make adjustments in inappropriate circumstances**

Without prejudice to DNOs' view that the net to gross adjustment for LRE (SpC 3.11) should not be modified into the RIIO-ED2 licence, we also note the following issues with the condition.

We recognise that Ofgem has moved this condition to be subject to statutory modification. There is, however, some ambiguity and omission remaining in the drafting of the condition that merits correction even in the context of statutory modification, because they fundamentally call into question the purpose of the adjustment or the role of a DNO's evidence in the process.

**Issue:**

The drafting of 3.11.2 suggests that DNOs cannot justify that an adjustment is required.

**Consequence:**

This wording suggests that the adjustment is expected to operate asymmetrically, whereas our expectation is that it can operate both to increase as well as decrease allowances. It also suggests that adjustments can only be made if a DNO cannot explain why the percentage is materially different, whereas the DNO's explanation may actually show that an adjustment is required. This also contradicts the intent of paragraph 3.11.6(b).

**Fix:**

Change the text of 3.11.2 to read:

*"The effect of this condition is to adjust allowances where the actual percentage of Gross Load Related Expenditure provided by Specific Customer Funded Reinforcement during the Price Control Period falls outside the Specific Customer Funded Reinforcement Percentage Band and either:*

*(a) the licensee has not adequately explained why the actual percentage of Gross Load Related Expenditure provided by Specific Customer Funded Reinforcement during the Price Control Period falls outside the Specific Customer Funded Reinforcement Percentage Band; or*

*(b) the licensee has justified that an adjustment is required,*

*unless this has already been funded by other Load Related Expenditure mechanisms in the Price Control Period."*

**Issue:**

The circumstances under which the Authority may modify allowances under this condition (paragraph 3.11.9) do not allow Ofgem to take account of information provided to it under 3.11.7 and 3.11.8.

The same paragraph also does not allow Ofgem to take account of allowances that have already been reduced via the various load allowance adjustment mechanisms that operate at the end of RIIO-ED2.

**Consequence:**

The wording on 3.11.9 means that it is not clear that Ofgem is able to take account of the DNO's evidence in deciding whether an adjustment can be made.

This could result in allowance adjustments being made in inappropriate circumstances. For example, the current wording of 3.11.9 would allow Ofgem to modify allowances in circumstances where a

material change in connections funded proportion arises due to a change in work mix (such as a reduction in EHV general reinforcement being offset by an increase in connections related reinforcement) even if the net costs were unchanged.

**Fix:**

The wording of 3.11.9 needs to be better articulated to explain the circumstances that we think Ofgem has in mind. One option might be:

*“After the Price Control Period the Authority may modify the value of NGLREt where:*

- (a) the Actual Percentage of Gross Load Related Expenditure has fallen outside a Specific Customer Funded Reinforcement Percentage Band;*
- (b) either*
  - i) the licensee has not adequately explained why the actual percentage of Gross Load Related Expenditure provided by Specific Customer Funded Reinforcement during the Price Control Period falls outside the Specific Customer Funded Reinforcement Percentage Band; or*
  - ii) the licensee has justified that an adjustment is required; and*
- (c) allowance adjustments have not already been made for the relevant Load Related Expenditure under Part K of Special Condition 3.2 (Uncertain Costs Re-openers) or through Special Condition 3.9 (Load Related Expenditure volume drivers) or [words to capture other end of R110-ED2 load closeout modifications see section 1 above].”*

**Issue:**

Sub-paragraph 3.11.7(b) is written asymmetrically. It only considers the circumstances where connecting customers fund a greater proportion of LRE and does not consider the circumstances where connecting customers fund a lower portion.

**Consequence:**

As drafted, it could be inferred from this sub-paragraph that adjustments would only be expected if connecting customers have funded a greater proportion of LRE. Our understanding is that this mechanism would be expected to operate symmetrically.

Additionally, as Ofgem’s decision to not include the additional costs associated with the outcome of the Access SCR for several years of the Price Control Period means that it is expected that connecting customers will pay a lower proportion for many projects, it also means that Ofgem has not required the information that is likely to be needed to explain any material change in the customer funded proportion.

**Fix:**

In section 8, we propose that paragraph 3.11.7 should be amended to remove the sub-paragraphs to prevent an obligation being introduced that DNOs would be unable to comply with. That change would also resolve this issue.

However, if Ofgem opts to resolve the issue in section 8 using a different solution, sub-paragraph 3.11.7(b) should be expanded to

*“reasons why reinforcement that was forecast to be funded through Load Related Expenditure at the outset of the Price Control Period has in fact been delivered through Specific Customer Funded Reinforcement or vice versa.”*

**8. Submission requirements include some aspects that DNOs may be unable to comply with and others that do not have any clear role in Ofgem’s allowance setting process**

**Issue(s):**

The submission requirements for both the LRE Re-opener and the net to gross LRE adjustment need more consideration.

There are examples in both mechanisms of:

- a) Requirements that DNOs will be unable to meet because Ofgem has not provided sufficient detail of the assumptions made at FD; and
- b) Requirements that would be onerous to comply with without any clear benefit to or role in Ofgem’s assessment of the allowance adjustment.

For example:

- a) SpC 3.11 does not set out the Gross LRE or the Specific Customer Funded Reinforcement values that are assumed in each DNO’s baseline percentage of Gross LRE. Furthermore, it is unclear how the allowances for Access SCR costs have impacted the values. DNOs will need details of these in order to explain any material variance between actual and baseline assumptions. These should be added as appendices to SpC 3.11 so that they are readily accessible to DNOs for any 2028 reporting.
- b) SpC 3.11.7(a) requires DNOs to provide a detailed explanation for any changes in the number of connection projects involving Specific Customer Funded Reinforcement relative to expectations at the start of the Price Control Period. This level of required explanation is not available to DNOs as it relates to customer behaviours. DNOs can provide the data about numbers of connections projects but will not necessarily be able to explain why customer behaviour has changed.
- c) SpC 3.11.7(b) requires DNOs to provide details of “why reinforcement that was forecast to be funded through LRE at the outset of the Price Control Period has in fact been delivered through Specific Customer Funded Reinforcement”. However, DNOs can only provide this information if Ofgem provides details of the individual projects that it has assumed will be undertaken and which would be associated with connections in its FD allowances.
- d) SpC 3.11.7(c) requires the DNO to provide details of changes in the licensee's use of contractors. We recognise that insource/outsource decisions change the direct/indirect cost

boundary and, therefore, the level of gross LRE costs. However, without details of which activities Ofgem assumes are insourced or outsourced at FD, it is impossible for DNOs to quantify the effect of this on the Actual Percentage of Gross Load Related Expenditure. We also do not know how Ofgem would reflect this data in any allowance adjustment calculation.

- e) The requirements in Appendix 9 of the RIIO-2 Re-opener Guidance and Applications Requirements are unclear about the level of data required for projects that will have already been undertaken. The submission requirements seem more suited to projects that are yet to commence. It is also unclear whether the requirements relate to all proposed projects (including those for which Ofgem has already been provided with EJPs or just for new projects that materially contribute to the scope of the re-opener request.
- f) Appendix 9 of the RIIO-2 Re-opener Guidance and Applications Requirements requires DNOs to provide EJPs for secondary activities. As many secondary network activities will fall within the scope of the volume drivers, this requirement seems onerous for what may be an immaterial amount of expenditure.

**Consequence:**

The drafting of SpC 3.11.7 could result in a DNO's inability to provide data being deemed a breach of its licence.

In the case of the LRE Re-opener, the inability to provide the required data could potentially cause a re-opener request to be inappropriately disallowed or delayed.

The requirement to provide data that will not be helpful to Ofgem's analysis causes unnecessary costs to be incurred that consumers will ultimately share.

**Fix:**

More work is required to consider (a) what data Ofgem will require and (b) provide DNOs with more information about Ofgem's own assumptions at FD to allow them to comply with the requirements.

If SpC 3.11 is modified into the licence, the wording of paragraph 3.11.7 should be amended to prevent an obligation being introduced that DNOs would be unable to comply with (with all sub paragraphs removed):

*"Where the licensee's Actual Percentage of Gross Load Related Expenditure has fallen outside its Specific Customer Funded Reinforcement Percentage Band, the licensee must include a detailed explanation in the report required by paragraph 3.11.6 of factors relevant to the Actual Percentage of Gross Load Related Expenditure falling outside the Specific Customer Funded Reinforcement Percentage Band."*

Further discussions should be held between DNOs and Ofgem during the Price Control Period to further agree submission requirements for both the LRE Re-opener and any report required under paragraph 3.11.6. Modifications to Appendix 9 of the RIIO-2 Re-opener Guidance will be required to

achieve this but we believe that these can be made during RIIO-ED2 provided that the modifications are made adequately prior to the first LRE Re-opener window. We include a number of examples of changes that are required to the RIIO-2 Re-opener Guidance document in our issues log.

**9. Legal status of documents/ modifications has not been consistently implemented, and document hierarchy is unclear**

**Issue(s):**

We recognise that Ofgem proposes changes to the legal status of some of the various documents or modifications associated with the suite of LRE uncertainty mechanisms from those previously consulted on. DNOs have different views on the acceptability of the proposed legal status changes and will share concerns directly. Without prejudice to some DNOs' views that the status should not change, the following issues relate to the enactment of the proposed change:

The change in legal status has not been enacted consistently across all documents. For example:

- a) SpC 3.9 sets out that the Volume Drivers Governance Document has the status of a licence instrument that is part of SpC 3.9 (i.e. suggests it has the status of a licence condition), whereas paragraph 1.5 of the Volume Drivers Governance Document sets out that "this Governance Document is subordinate to the licence"; and
- b) Paragraph 2.17 of the Volume Drivers Governance Document sets out that the Volume Drivers Workbook "forms part of this LRE Volume Drivers Governance Document", suggesting that it also has the status of a licence condition. However, the same paragraph also states that it "will form part of the RRP", suggesting that it, therefore, has the status of an Associated Document (i.e. a RIG).

The suite of documents does not set out the legal hierarchy between the various documents that should be followed in the event of a conflict between documents.

No guidance has been provided on the population of the Volume Drivers Workbook or the timing of any required data submissions. Ofgem has indicated that this will be made available to the DNOs at the same time that the modification notices are published. This will, therefore, not be available in time to allow DNOs to consider whether the Volume Drivers Workbook is acceptable as a document that may have the status of a licence condition. DNOs should be given a proper opportunity to review and comment on that draft guidance prior to modification notices being published.

No change has been made to the definition of Associated Document to remove the volume driver documents from the scope of that term.

**Consequence:**

The inconsistency in articulation of the legal status of the various documents creates confusion about the status of the various documents, the process that would need to be followed to modify them and any appeal rights that would be afforded at any future modification.

The lack of a formal hierarchy means that we cannot fully assess the impact of the conflicts between the various documents that we have identified to date or any that are identified at a future date.

The Volume Drivers Workbook requires data that DNOs have not routinely reported. It may be subject to differences in interpretation. This could result in different allowance adjustments being applied for different DNOs simply because of differences in interpretation.

**Fix:**

- a) Confirm the intended legal status of the various documents making up the suite of Load Related Expenditure uncertainty mechanisms, and draft consistently in all documents.
- b) Include a formal legal hierarchy between the various documents, following the style used for the equivalent hierarchy in the PCFH (PCFH para 1.5). The scope of this hierarchy list should include SpC 3.2, SpC 3.9, SpC 3.11, the Volume Drivers Governance Document, the RIIO-2 Re-opener Guidance and Application Requirements Document, the Volume Drivers Workbook, the PCFM, Associated Documents including the PCFM Guidance, and the FDs.
- c) Provide detailed guidance on how the Volume Drivers Workbook is to be populated by DNOs. If the Volume Drivers Workbook is to have the status of a licence condition, the associated guidance must be available in time for DNOs to make a formal decision about the acceptability of the new condition.
- d) If any of the various volume driver documents are to hold the status of a licence condition, explicitly remove the relevant documents from the scope of the defined term “Associated Document”, following the approach used for ED2 Price Control Financial Instruments.

**10. The scope of activities to be included within the volume driver remains unclear**

**Issue(s):**

The drafting of the volume driver still is not clear as to whether connections are included or excluded. Likewise, it doesn’t actually say that the relevant volumes must be within the scope of LRE (e.g. for circuit installed).

In the issues log, Ofgem says this has been clarified but we cannot see where this has occurred.

The scope is implied by virtue of the RRP data sheets that are referred to in the Volume Drivers Governance Document, but the wording does not actually limit the volumes to those activities.

**Consequence:**

There remains scope for differences in interpretation of the scope of this condition. Consequently, there is also scope for differences in interpretation of the scope of the LRE Re-opener.

**Fix:**

SpC 3.9 should explicitly set out the scope of the volume driver. For example, the scope of the condition is confined to the activities set out in Appendix 1 and Appendix 2 of SpC 3.9 that are associated with the delivery of CV2 secondary reinforcement activities (as further defined in the RIGs).



**11. Incorporation of flexibility services into SpC 3.9 is ambiguously implemented, and contradicts some of the calculations in the Volume Drivers Workbook**

The allowance calculations to incorporate flexibility services into the volume driver are not clearly written, are contradictory between SpC 3.9 and the Volume Drivers Workbook and can be subject to different interpretations.

DNOs discussed the confusion with the drafting of allowance adjustments related to flexibility services with Ofgem during the load policy meeting on 10 January 2023. Ofgem agreed to particularly revisit this area of drafting to ensure that it is aligned with policy intent.

**Issue:**

We understand from slide 3 of Ofgem’s slide deck for 10 January meeting that “Flexibility ex ante allowances sit outside of the secondary reinforcement volume driver and therefore will not be automatically adjusted down.”

Without prejudice to the fact that not all DNOs agree with this policy, if ex ante allowance are not to be included within the opening variant load values, the policy creates a mis-match between the allocation of ex ante allowances and the operation of SpC 3.9.

The formula at paragraph 3.9.4 calculates the full allowance for flexibility services, and neither checks whether the original ex ante allowance has been exceeded nor removes the ex ante funded allowances from the amount allowed through the volume driver.

**Consequence:**

The effect of this is to double count the ex ante allowances for flexibility services in both non variant load allowances and the recalculated volume driver allowances.

**Fix:**

If flexibility services ex ante allowances are to be included in non-variant allowances, with any further allowances provided only once the total (recalculated) flexibility services allowance exceeds the allowance provided ex ante, consequential changes should be made to SpC 3.9.

**Issue:**

The algebra in SpC 3.9 used to calculate the unit cost for flexibility services contracts contradicts the calculations in the Volume Drivers Workbook. For example:

- a) SpC 3.9 sets out that the unit cost calculation uses WACC for year  $t$  (presumably the year in which the flexibility contract commences) and sets out that WACC is defined in the PCFH (which will calculate different annual WACC values) whereas the Volume Drivers Workbook is populated with just one WACC value that is used in all years of RIIO-ED2.
- b) SpC 3.9 provides no constraint to the forecast number of years of reinforcement deferral, whereas Volume Drivers Workbook seems to constrain the maximum number of deferral years to 5 years.

**Consequence:**

It is unclear whether the algebra for calculating flexibility services unit costs in SpC 3.9 or in the Volume Drivers Workbook should be followed to calculate allowances associated with flexibility services.

**Fix:**

To address the difference in how WACC is applied to unit cost calculations:

- a) We assume that the annual WACC values calculated via the PCFH methodology should be used to calculate unit costs. With the WACC for the year in which the flexibility contract commences being used to calculate the unit cost (i.e. no need to forecast future changes in WACC – because the investment decision would be made based on the prevailing WACC).
- b) To achieve this, no change is needed in SpC 3.9, but the Volume Drivers Workbook would need to be evolved to:
  - i) Include 5 cells that would be populated with the annual WACC values for each year (to align with PCFM);
  - ii) Replicate the flexibility unit cost calculations (currently cells K89: O95) to create 5 annual sets of unit costs (so all unit costs for flexibility contracts let in 2023-24 would be based on the 2023-24 WACC, etc); and
  - iii) Update the formula for the unit cost calculations to point to the annual unit costs.

To address the difference in the definition of the number of years deferral that can be included in the unit cost calculation:

- a) Confirm Ofgem’s policy intent here; and
- b) Ensure that both SpC 3.9 and the Volume Drivers Workbook implement that policy in an internally consistent manner, either by adding additional “Contract length” columns/ different formulaic structure in the Volume Drivers Workbook or by amending the definition of “n” in SpC 3.9.

**Issue:**

It is not clear in SpC 3.9 nor the Volume Drivers Workbook whether a flexibility contract that runs for a number of years should only be counted once, presumably in the first year of the contract, or in each year that the flexibility contract is put in place.

**Consequence:**

Different interpretations could lead to the unit cost for any one project being allowed multiple times.

**Fix:**

This should be clarified in the Volume Drivers Governance Document, ensuring that the “counting” of any contract is applied internally consistently with the calculation of the associated unit cost.

**Issue:**

No reporting mechanism has been provided in the Volume Drivers Workbook to capture the data required by paragraph 5.8 of the Volume Drivers Governance Document (reporting of information for each asset where flexibility has been used to defer investment).

**Consequence:**

As this data will be required to be captured from 1 April 2023, and data capture systems put in place to achieve this, DNOs need sight of Ofgem's proposed format in order to capture data in the required format.

**Fix:**

Ofgem should provide DNOs with sight of any standard reporting requirements and guidance as soon as possible.

If this data is to be reported in the Volume Drivers Workbook, the reporting requirements and associated guidance would need to be incorporated in time for the early February modification notice being issued. Otherwise, a full licence modification process would be required to incorporate the additional requirements as they would not fall within the self-modification rules set out in Part C of SpC 3.9.

**12. Important wording changes needed in the description of the circumstances under which a LRE Re-opener adjustment may be made**

**Issue:**

Sub-paragraph 3.2.77(g) inappropriately requires DNOs to submit evidence "including evidence of the efficiency of the Load Related Expenditure".

Similar wording is included in paragraph 3.19 of the Re-opener Guidance and Application Requirements Document which requires the submission of "evidence to justify why the level of costs is efficient".

**Consequence:**

DNOs have had considerable discussion with Ofgem at LDWG regarding the fact that such a requirement is not appropriate, for example 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 which Ofgem have accepted and rectified in all other places. (An example relevant to the LRE Re-opener is that DNOs would be unlikely to be able to provide evidence of the efficiency of expenditure associated with increased New Transmission Capacity Charges as the costs would be incurred by the relevant Transmission Licensee).

As a consequence, such wording remaining in the condition could lead to a re-opener application being inappropriately disallowed.

For all other Parts of SpC 3.2 such wording (or equivalents) has been removed by Ofgem.

**Fix**

In line with other Parts of SpC 3.2, this requirement should be removed. This would leave paragraph 3.2.77(g) reading:

*“provides such detailed supporting evidence as is reasonable in the circumstances”.*

The second sub bullet of paragraph 3.19 of the Re-opener Guidance and Application Requirements Document should be amended to read

*“why the level of costs is efficient. Please note, the efficient level of costs will be determined at the time of any determination of a Re-opener application.”*

The RIIO-2 Re-opener Guidance already defines specific requirements for submissions.

**Issue:**

Sub-paragraph 3.2.75(c) sets out that one of the criteria to be met for the LRE Re-opener is that the expenditure “is not provided for by ex ante allowances”.

This wording is too loose.

**Consequence:**

This requirement could potentially be incorrectly interpreted to refer to all totex ex ante allowances or all LRE allowances.

Also, given that DNOs may have previously had allowance adjustments made under the re-opener, it is not clear that it includes any allowances previously made under the LRE Re-opener (which could have awarded ex-post allowances for some years).

**Fix:**

Sub paragraph 3.2.75(c)(i) should be amended to read:

*“is not provided for by the sum of (a) ex ante allowances for activities within the scope of the Load Related Re-opener (as set out in Appendix X) plus (b) any previously directed values of  $LRE_t$ .”*

- 13. Amendments to the various transmission connection point charges definitions have fundamentally changed the boundary between Load Related Expenditure and Pass-through in a way that is not consistent with our understanding of Ofgem’s policy**

**Issue:**

Ofgem’s definitions of New Transmission Capacity Charges and Transmission Connection Point Charges have fundamentally changed the boundary between pass-through and Load Related Expenditure compared to RIIO-ED1.

The RIIO-ED1 equivalent terms (New Transmission Capacity Charges, Pass-through Transmission Connection Point Charges, Transmission Connection Point Charges) limited the portion of

Transmission Connection Point Charges that was included with Load Related Expenditure to those aspects that are (in whole or in part):

- a) energised after the start of the price control; and
- b) pursuant to a requirement of the licensee for the provision of new or reinforced connection points between the GB Transmission System and the licensee's Distribution System.

All other Transmission Connection Point Charges were funded via pass-through.

The wording of the RIIO-ED2 definitions does not include any equivalent parameter to limit the costs to fall within Load Related Expenditure to those arising due to the DNO requesting a new or reinforced grid connection point. It would, for example, include Transmission Connection Point Charges due to all TO assets that are replaced due to age/condition and energised during in RIIO-ED2.

The RIIO-ED1 defined terms also included the wording "in whole or in part" allowing that, pursuant to a DNO's requirement for a reinforced grid connection point, where the TO identifies the need to replace existing assets – and where those assets are not reinforced – it is only the assets that are either new or reinforced that are included within Load Related Expenditure. Ofgem's proposed use of "projects energised" would result in the costs associated with all impacted assets being treated as Load Related Expenditure.

**Consequence:**

This is a fundamental change in policy that was not signalled by Ofgem.

Changes in Transmission Connection Point Charges due to TO initiated work, or where the assets are not for a new or reinforced connection point, would not meet the scope of the Load Related Re-opener in 3.2.75, leaving DNOs exposed to the full cost of meeting these costs (as no ex ante allowance has been made for those aspects of Transmission Connection Point Charges at FD). This would clearly be an unacceptable situation.

**Fix:**

Assuming that this change is unintended, changes are required to the RIIO-ED2 defined terms to set the boundary between Load Related Expenditure and pass-through back to the RIIO-ED1 boundary.

Amend the wording of the new ED2 terms to read:

*"Transmission Connection Point Charges means the sum of: (a) charges payable by the licensee that are levied by a Transmission Licensee as connection charges by direct reference to the number or nature of connections between the licensee's Distribution System and the GB Transmission System, and includes any associated Transmission Use of System Charges and any Remote Transmission Asset rentals payable by the licensee; and (b) charges payable by the licensee to another Electricity Distributor in respect of units transported from that Electricity Distributor's Distribution System; less any charges under (a) and/or (b) that meet the definition of New Transmission Capacity Charges."*

*"New Transmission Capacity Charges means those elements of Transmission Connection Point Charges that are attributable (in whole or in part) to connection assets first becoming energised on or after 1 April 2023 pursuant to a requirement of the licensee for the provision of new or reinforced connection points between the GB Transmission System and the licensee's Distribution System."*

**14. The scope of the review of the Volume Drivers during RIIO-ED2 introduces regulatory uncertainty during the early years of the Price Control Period**

**Issue:**

DNOs recognise that the LRE Volume Drivers are new mechanisms for RIIO-ED2 and agree that it is sensible to review their effectiveness after a few years' operation.

The scope of the review of LRE Volume Drivers that is set out in chapter 5 of the Volume Drivers Governance Document is currently only defined at a high level. More work will be required during the early years of RIIO-ED2 to define the scope of this review more closely. We accept that the scope will be informed by the experience of operating the volume driver mechanism during the first few years of RIIO-ED2 and note that any changes that arise as a result of the review will be subject to the statutory modification process set out in S11A of the Electricity Act 1989.

The expectation that SpC 3.9 may be modified during RIIO-ED2 creates some uncertainty regarding how allowances may be calculated for activities undertaken during the first years of RIIO-ED2. In particular:

- a) Chapter 5 of the Volume Drivers Governance Document does not make it clear that the any modifications that arise as a consequence of the review will only apply going forward i.e. for Regulatory Years after the review has concluded. The chapter could be read as posing a risk of retrospective modifications to the licence. Our understanding, based on Ofgem's response to issues log entry 133, is that any changes that arise as a consequence of the review would not act retrospectively; and
- b) The phrasing of the second bullet of paragraph 5.7 could be read to suggest than one outcome of the review might be reductions in the caps that apply to the volume drivers. Any such reduction could result in expenditure that DNOs had expected to be funded via the volume driver no longer being funded. We do not believe that Ofgem intends that the review could reduce the caps, i.e. this aspect of the review would only allow for increases to the caps.

**Consequence:**

The potential for changes to be made as part of the review of LRE Volume Drivers that could affect allowances for activities undertaken during the first years of RIIO-ED2 undermines regulatory certainty and could result in delays to investment during the early years of RIIO-ED2.

**Fix:**

An additional paragraph should be introduced in chapter 5 of the Volume Drivers Governance Document (as a new paragraph 5.6) setting out that:

*“Any changes agreed as a result of the review of LRE Volume Drivers will be enacted on a forward-looking basis. No changes will be made to allowances for volumes that have already been delivered.”*

An additional sentence should be added to the second bullet of paragraph 5.7 of the Volume Drivers Governance Document setting out that:

*“No reductions to the volume driver caps will be made as a result of the review of LRE Volume Drivers.”*

Additionally, discussions will be required between Ofgem and DNOs during RIIO-ED2 to further refine the scope of the review of LRE Volume Drivers. The outcome of these discussions may require changes to the Volume Drivers Governance Document. It is possible that the changes to the scope of the review may need to be made under S11A of the Electricity Act 1989.

## Appendix 2

**Issues and inconsistencies for RPEs in various allowance modification processes****1. RPEs and re-openers**

- 1.1 RPE allowances are not being calculated in the PCFM for re-openers (these are classed as “RPEs Don’t Apply”).
- 1.2 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.
- 1.3 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 paragraph 3.20 of this document allowing DNOs to apply for allowance adjustments that are inclusive of RPEs, as follows:

*“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 UIOLI mechanisms**

- 2.1 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:
  - a) 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.
  - b) The cap in the licence has been calculated without any consideration of RPEs. This means that RPEs could artificially constrain (or inflate) the amount DNOs can spend on these cost areas.



We suggest the values of the caps for each UIOLI allowance term in SpC 3.4 Appendices 1 and 2 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 PCDs

- 3.1 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.
- 3.2 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.
- 3.3 We suggest that a solution would be for Ofgem to exclude the implied contribution of RPEs that would be calculated using the methodology set out in chapter 5 of the PCFH 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.
- 3.4 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

- 4.1 NARM 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.
- 4.2 However, the calculation of the Outturn Unit Cost of Risk 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.

4.3 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.

4.4 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), as follows:

*"Incurred NARM Expenditure 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."*

Please see the "Common DNO Issues Log" provided with this response.

## Appendix 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**

- 6.1 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 FD. The various Parts of SpC 3.2 require this in different ways, depending on the nature of the re-opener, for example:
- a) “additional costs associated with such changes” (SpC 3.2.6);
  - b) “relative to the assumptions used by Ofgem to set allowances” (SpC 3.2.14); and
  - c) “is not provided for by ex ante allowances” (SpC 3.2.75(c)).
- 6.2 With the exception of those re-openers that have opening 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.
- 6.3 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.
- 6.4 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 required 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.
- 6.4 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.
- 6.5 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.
- 6.6 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.
- 6.7 It is imperative that DNOs are given the opportunity to check these values prior to modification notices being issued.

Please see the “Common DNO Issues Log” provided with this response.

## Appendix 4

**Amendments required to SpC 1.3 (Common Procedure)****1. The definition of Associated Document is unclear and does not provide certainty as to the scope of SpC 1.3 Part A****1.1** 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.”*

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

- a) Ofgem’s issues log suggests that the RIGs should fall in scope but the RIGs are not issued or modified under SpC 1.3 and SLC 46 confirms the associated process.
- b) As the 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 Volume Drivers Governance Document and Network Asset Risk Workbook, consistent with the ED2 Price Control Financial Instruments.

**1.3** Consequently:

- a) The definition of Associated Document should list all of the Associated Documents that can be modified under SpC 1.3.
- b) 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****2.1** 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.**2.2** 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.**2.3** The process needs to be expanded to explain:

- a) The process that Ofgem will follow if the DNO requests an additional window be directed;
- b) The factors that Ofgem may consider in deciding whether to direct an additional application window; and

- c) Any minimum time period between the date of the direction and the application window.

2.4 Consequently, the following wording should added:

*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 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.*

- 2.5 Some further information is provided in the Re-opener Guidance Document (Appendix 12, paragraph 1.32). However, 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 directly or indirectly in Customers' 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**

- 3.1 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.
- 3.2 This cross-referencing has been undertaken from conditions where Part A is relevant but has not been undertaken for Parts B or C.
- 3.3 The process in Part B of SpC 1.3 needs to be cross referenced from all relevant conditions and Parts, as follows:

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

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),  
....”*

Please see the “Common DNO Issues Log” provided with this response.

## Appendix 5

## NARMS expenditure – sign transposition

SpC 3.1.30, SpC 3.1.31, SpC 3.1.32, SpC 3.1.35, SpC 3.1.36 and SpC 3.1.37 should be amended as set out below, for the reasons noted:

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.	$[NRO_{BL} * (1 + DB_L)] \geq NRO_{OA} \geq [NRO_{BL} * (1 + DB_U)]$
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	<p>NRO(OAD) is calculated in two different ways depending on whether the delivery is under or over the Baseline Network Risk Output.</p> <p>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.</p>	<p>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</p> <p>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</p>

3.1.36	<p>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.</p> <p>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".</p>	<p>UCR<sub>AD</sub> - is the Adjusted Unit Cost of Risk (£/£risk), which is the <b>higher</b> of the Baseline Unit Cost of Risk (UCR<sub>BL</sub>), derived in accordance with 3.1.38, and the Outturn Unit Cost of Risk (UCR<sub>OR</sub>), derived in accordance with paragraph 3.1.39.</p>
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Please see the "Common DNO Issues Log" provided with this response.



**Appendix 6****Incorporation of flexibility services into SpC 3.9**

Northern Powergrid's own view on the drafting and algebraic changes that could achieve the intent that Ofgem described during the load policy meeting on 10 January 2023 is set out below. However, we note that Ofgem's intended approach to allowance calculations is quite complex to implement and that much simpler approaches could achieve the same effect (on an NPV basis) without the need for introducing such complexity.

3.9.4 The value of  $SRVD_t$  is derived in accordance with the following formula:

$$SRVD_t = \frac{\sum_i (SRUC_{t,i} \cdot SRCD_{t,i})}{1,000,000} + SRFS_t$$

where:

- $SRUC_{t,i}$  means the unit cost of activity type i, set out in Appendix 1;
- $SRCD_{t,i}$  means the volumes of activity delivered of type i, as set out in Appendix 1; and
- $SRFS_t$  means the allowance for flexibility services deferral value above ex ante allowances, as set out in paragraphs 3.9.5 and 3.9.6.

3.9.5 For the Regulatory Year commencing on 1 April 2023, the value of  $SRFS_t$  is derived in accordance with the following formula:

$$SRFS_t = \begin{cases} 0, & \text{where } FSNRA_t \leq FSAA_{ED} \\ FSNRA_t - FSAA_{ED}, & \text{otherwise} \end{cases}$$

where:

- $FSNRA_t$  means the notional flexibility services recalculated allowance, as calculated in paragraph 3.9.7
- $FSAA_{ED}$  means the ex ante allowance provided for the DNO for flexibility services for the five years of the Price Control Period, as set out in Appendix 3.

3.9.6 For Regulatory Years commencing on or after 1 April 2024, the value of  $SRFS_t$  is derived in accordance with the following formula:

$$SRFS_t = \begin{cases} 0, & \text{where } \sum_{n=2023/24}^t FSNRA_n \leq FSAA_{ED} \\ \sum_{n=2023/24}^t FSNRA_n - FSAA_{ED} - \sum_{n=2023/24}^{t-1} SRFS_n, & \text{otherwise} \end{cases}$$

3.9.7 The value of  $FSNRA_t$  is derived in accordance with the following formula:

$$FSNRA_t = \left( \frac{\sum_i SRFSUC_{t,i} \cdot SRFSCD_{t,i}}{1,000,000} \right)$$

- $SRFSUC_{t,i}$  means the unit cost for secondary reinforcement capacity type i, that is being deferred by flexibility services as calculated in paragraph 3.9.8;

$SRFSCD_{t,i}$  means the volumes of flexibility service contracts commencing in period  $t$  that deferred secondary reinforcement of the type  $i$ , as set out in Appendix 1; and

3.9.8 The value of  $SRFSUC_i$  for gross MVA deferred through the procurement of flexibility services is derived in accordance with the following formula:

$$SRFSUC_{t,i} = SRUC_{t,i} \times \left( 1 - \left( \frac{1}{(1 + WACC_t)^n} \right) \right)$$

where:

$SRUC_{t,i}$  means the unit cost for secondary reinforcement capacity type  $i$  set out in Appendix 1, that is being deferred by flexibility services;

$WACC_t$  means vanilla weighted average cost of capital, derived in accordance with Chapter 4 of the ED2 Price Control Financial Handbook; and

$n$  means the forecast number of years of reinforcement deferral.

3.9.9 The value of SRVD across the Price Control Period cannot exceed [£Xm].

Additionally:

The LRE Volume Drivers Workbook should be updated to include these calculations.

Add a new Appendix 3 setting out DNOs' annual ex ante flexibility services allowances.

Amend the title of Appendix 1 to read "SRVD<sub>t</sub> and SRFSCD<sub>t</sub> unit cost by activity type (£)".

Amend the column title of first column in Appendix 1 to read "Activity delivered SRCD<sub>i</sub> or activity deferred by flexibility services SRFSCD<sub>i</sub>".

Remove the flexibility services row 7 from Appendix 1 to avoid any ambiguity that it also flows into the formula for traditional solutions in 3.9.4.

## Response by Northern Powergrid (Northeast) plc and Northern Powergrid (Yorkshire) plc to the consultation in respect of Associated Documents issued on 14 December 2022

### 1. Data Best Practice Guidance

- 1.1. We note that Ofgem intends to update the Data Best Practice Guidance appropriately for references to the RIIO-ED2 price control and to hold a consultation on changes to the Data Best Practice Guidance. We will continue to engage in that process.

### 2. Digitalisation Strategy and Action Plan Guidance

- 2.1. The first bullet point under “Schedule for Updating Digitalisation Strategy and Action Plan for RIIO-2 Licensees” in paragraph 1.5 is inconsistent with SpC 9.5.2 of the RIIO-ED2 licence, which requires the DNO to publish its Digitalisation Strategy on, or before, 1 April 2023.
- 2.2. The second bullet point under “Schedule for Updating Digitalisation Strategy and Action Plan for RIIO-2 Licensees” in paragraph 1.5 is inconsistent with SpC 9.5.5 of the RIIO-ED2 licence, which requires the DNO to publish its Digitalisation Action Plan on, or before, 30 June 2023.
- 2.3. A separate section headed “Schedule for Updating Digitalisation Strategy and Action Plan for RIIO-ED2 Licensees” should be inserted into paragraph 1.5 of the Digitalisation Strategy and Action Plan Guidance that is consistent with SpC 9.5.2 and SpC 9.5.5.
- 2.4. We note that Ofgem intends to update the Digitalisation Strategy and Action Plan Guidance appropriately for references to the RIIO-ED2 price control and to hold a consultation on changes to the Digitalisation Strategy and Action Plan. We will continue to engage in that process.

### 3. Distribution System Operation Incentive Governance Document

- 3.1. The definition of “Curtaillable Connection” in Appendix 6, the Glossary, is not aligned with the Access SCR policy determined by the Authority because it does not specify that Curtaillable Connections only apply in respect of connection applications made on or after 1 April 2023. This drafting could give rise to an interpretation that existing “flexible connections” are Curtaillable Connections and that the DNO would have to retrospectively include such existing “flexible connections” in the Curtailment Efficiency Outturn Performance Metric under SpC 4.8.8.

The definition of “Curtaillable Connection” should, therefore, be amended to align it with the Authority’s Access SCR policy, as follows:

*“Curtailed Connection means a connection in respect of which an application has been made to the licensee on or after 1 April 2023 and where the Customer’s Maximum Import Capacity and/or Maximum Export Capacity is subject to Curtailment.”*

- 3.2. We recognise that Ofgem has already changed the DSO metric formulae such that the Final Determinations and the Distribution System Operation Incentive Governance Document are inconsistent. Consequently, clarifications and modifications are required in the DSO metrics section of the Distribution System Operation Incentive Governance Document. Most importantly, there remain unresolved issues in the definition of the metrics for Secondary Network Visibility and Curtailment Efficiency in the Distribution System Operation Incentive Governance Document. In both cases there are difficulties with the operation of these metrics to incentivise the intentions set out by the Authority in its Final Determinations.
- 3.3. We note that Ofgem intends to further develop the Distribution System Operation Incentive Governance Document. We will continue to engage in that process and provide further comments as appropriate in order to ensure the drafting of the Distribution System Operation Incentive Governance Document and the relevant formulae give effect to the Authority’s policy decisions as set out in its Final Determinations.

#### **4. RIIO-2 Price Control Deliverables Reporting Requirements and Methodology Document**

- 4.1. During the overall RIIO-ED2 consultation process, we made clear to Ofgem the reasons why it was not appropriate to include in the licence a UIOLI mechanism in respect of the Cyber resilience PCDs and re-openers. The outcome was that Ofgem removed the Cyber resilience UIOLI mechanism from the informal consultation version of the licence.
- 4.2. 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.
- 4.3. 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 (“OT”) plans and Cyber Resilience OT Re-opener applications. There is, therefore, a significant conflict between the licence and Appendix 4.
- 4.4. 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 CROTRe 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:

- a) SpC 3.3.15(a) sets out that “where an output is Fully Delivered With An Alternative Specification and the DNO 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”.
  - b) 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 only in accordance with the given formula.
- 4.5. We note that there is some ambiguity in the FDs regarding this issue. However, Ofgem’s policy is correctly reflected by the absence of a Cyber resilience UIOLI mechanism from the licence.
- 4.6. The solution, therefore, is for Ofgem to:
- a) Confirm that any ambiguity in the FDs is wrong;
  - b) 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
  - c) Consult again on Appendix 4 to ensure that those changes are implemented correctly.

## **5. Other comments**

- 5.1. We have made further comments regarding the above and other Associated Documents that are generally of a clarificatory or presentational nature in the “Associated Documents Issues Log” provided with this response.

## Response by Northern Powergrid (Northeast) plc and Northern Powergrid (Yorkshire) plc to the consultation in respect of Guidance Documents issued on 14 December 2022

We have made comments on the Guidance Documents in respect of the Standard Licence Conditions that are generally of a clarificatory or presentational nature in the “Guidance Documents Issues Log” provided with this response.