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Date

31st March 2023

Contact / Extension

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Dear Mark,

Proposal to modify the Regulatory Reporting Pack (RRP), Regulatory Instructions and Guidance (RIGs) and the Price Control Financial Model (PCFM) Guidance for RIIO-ET2

SP Energy Networks (SPEN) represents the transmission licensee of SP Transmission plc (SPT), as well as the distribution licensees of SP Distribution plc and SP Manweb plc. SP Transmission owns, develops, and maintains the onshore electricity transmission network in the south of Scotland. SPEN also own and operate the electricity distribution networks in the south of Scotland (SP Distribution) which serves two million customers, and Merseyside and North Wales (SP Manweb) which serves one and a half million customers.

This letter, and attachments, constitutes our response to a Notice, issued on 28th February 2023, pursuant to of Part A of Standard Licence Condition B15 (Regulatory Instructions and Guidance)² and paragraph 8.2.23 of Special Condition 8.2 (Annual Iteration Process for the ET2 Price Control Financial Model) of the Electricity Transmission Licence, in respect of our proposed modifications. In principle, SPEN supports the proposed amendments listed in the Notice (extract in Appendix 1) as items 6 a), b), c), d), g), and i). A review has been undertaken of the supporting documents/tables and comments added to each document/table for clarity. The comments are, in general, of an administrative nature to enhance understanding and compliance with requirements. These documents are included in our response with attachments list in Appendix 2. There are a couple of exceptions which are described in detail herein.

SPEN consider the proposed amendment, noted under 6 f) to be premature in its withdrawal. Whilst guidance, noted under 6 e), is helpful it is, by virtue of a small set of examples, limited in its ability to establish key principles and provide robust interpretation to TOs to facilitate reliable, repeatable and

consistent cost splits. TOs have deployed appropriate processes to better attribute costs to activities and assets. This was evidenced in our year one submission, where SP Transmission has been at the forefront of disaggregating expenditure to assets for both actual and forecast processes. This is, however, heavily dependent on the availability of relevant cost categories, which may not be applicable to existing contracts. The proposal, as it stands¹, creates a risk of non-compliance with part of the RIGs for schemes where contracts have been, or are to be, awarded in the near future. The prior guidance under-pinned the RIIO-T2 Business Plan submission and year one reporting. We do not, therefore, consider that the section of the guidance has become redundant, at this time.

It is our view that further work between TOs and Ofgem is necessary to fully and properly establish robust, stable and commonly understood definitions across Direct, Indirect and Business Support Costs. The outcome of such work would facilitate more stable and enduring guidance, on this matter, that can then be applied within RIIO-T2 and better support future price controls no matter what form they take.

SPEN considers it would be inappropriate for Ofgem to exclude from the definition of totex in the RIGs any costs or legal fees incurred relating to an application for a Judicial Review or an appeal to the CMA in respect of a decision made by Ofgem (item 6 h)).

It is a fundamental principle of public law that the actions of a public body, such as Ofgem, should be able to be challenged either through Judicial Review or to the CMA through the specialised regulatory appeal regime. Ofgem's reasoning for excluding these legal costs is that "any legal challenge against an Ofgem decision would be in the interest of shareholders rather than the consumer". This is incorrect and presents an overly simplistic view of the process and a company's motivation for raising a legal challenge since there are a broad range of circumstances in which a licensee might raise a legal challenge. An effective appeals process is essential to ensure that consumers can also be confident that regulatory decisions are made in line with the legal duties of the regulator. BEIS recognise the importance of regulatory appeals to promote a fair, predictable and transparent process for consumers, as well as investors and companies, in their "Economic Regulation Policy Paper"².

Whilst the regime is aimed at protecting investors and companies as well as consumers, the interests of shareholders and consumers cannot be so easily separated since any actions by the regulator to undermine the broader regulatory framework can also lead to increased costs to consumers over time. This was an important point recognised by the CMA in the RIIO-2 CMA Energy Licence Modification

¹ Removal of clause, Where contractors have recharged the licensee for the primary purpose of performing direct activities which include costs for indirect activities but these are not explicitly costed in their invoice, all costs will be treated as direct. However, where the indirect activity is explicitly costed and detailed in their invoice this should be recorded against the relevant indirect activity".

² Economic Regulation Policy Paper, published January 2022

Appeals in 2021 and this formed part of the CMA's reasoning for upholding the outperformance wedge appeal ground. In the CMA's Final Determination³ they concluded at para 6.181(c) that the errors Ofgem had made meant there was "a realistic possibility that the outperformance wedge, if introduced, would also undermine broader regulatory certainty which could result in increased costs to consumers over time".

The legal challenge processes are also essential to ensure that licensees can challenge wrong and unlawful decisions. In the Energy Licence Modification Appeals, under Joined Ground D, the CMA found that Ofgem had acted ultra vires in its use of the direction-making powers to modify certain licence conditions. The CMA's decision on this point helped to clarify the scope of Ofgem's powers and set a precedent for future licence drafting across the energy industry. The public benefit of that appeal therefore extended beyond the parties who brought the appeal as it has had a wider public value in establishing precedent, clarifying the law and encouraging good decision-making by public bodies.

A legal challenge might also be raised in circumstances where Ofgem has decided to not award a licensee enough or additional totex allowances. A licensee might need to challenge this, for example, if they consider the totex allowance is inadequate to allow them to deliver the investment required in the network, which would also affect wider stakeholders including renewable energy projects needing to connect to the network to deliver the government's Net Zero targets. Other important stakeholders could therefore be impacted if Ofgem are not held accountable for their decisions through legal challenges.

It is therefore incorrect for Ofgem to state that a legal challenge would only be in the interests of shareholders. SPEN considers it would be inappropriate for Ofgem to remove these legal costs from the definition of totex since it would be unfair for shareholders to have to bear these costs in full due to the important role that legal challenges play in protecting consumers, other stakeholders and the wider public interest by allowing licensees to challenge decisions that are wrong, unlawful or could undermine broader regulatory certainty.

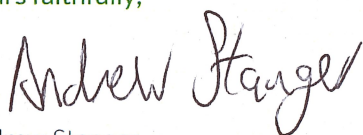
There are inter-related discussions taking place between TOs and Ofgem in relation to the wider PCFI consultation. There are overlaps in the amendments proposed, particularly in relation to the changing AIP timelines, which feature in the PCFM guidance as well as the PCFI. The timings and nature of the AIP processes are still being discussed in PCFI working groups which will have a knock-on effect on the PCFM guidance. It would not, at this time, be appropriate to provide responses to the PCFM document, noting it is expected to change as a result of the PCFI process. We reserve the right to

³ *Final Determination*, published October 2021

respond further on this matter when the PCFI process concludes and relevant documents⁴ are issued for consultation.

Please note our response is limited to the information included within the consultation documents.

Yours faithfully,



Andrew Stanger
Head of Revenue and Regulatory Economics

⁴ Due to expected changes to PCFM from PCFI process, it would be appropriate to include PCFM within PCFI consultation.

Appendix 1

Extract of Ofgem Notice: summary list of amendments

6. The main proposed amendments are briefly summarised below. They are:

a) Introduce a new Scheme_C&V_Load_Actuals tab which replaces information previously requested through the Scheme Meta data/scheme volume/scheme cost.

b) Introduce a new Scheme_C&V_Non-Load_Actuals tab which replaces information previously requested through the Scheme Meta data/scheme volume/scheme cost.

c) Introduce a separate reporting tab for Repairs activity which requires detail on the number of non-routine repairs and associated costs by asset category previously recorded on Repairs & Maintenance

d) Introduce new Analysis tabs to replace previous Co Cost Output tabs, which sets predefined points of analysis setting out Price Control performance in line with our approach at Ofgem, to assist TO's in their own analysis and for the production of the supporting narrative

e) Design activity definition RIGs clarification. We are seeking to provide clarity on our view on the manufacturing configuration design activity and its reporting. The cost for Asset Specific Designs are those which the licensee does not have direct control over and the decisions on how to meet the specification in function design are for the manufacturer/contractor to determine. These costs should be treated as a direct activity as they are deemed to be a legitimate purchase cost of the asset.






f) RIGs amendment: as a result of the granular reporting required for T2, all TO's have employed appropriate processes to attribute costs to activities and assets not specifically invoiced or categorised. As such, the subsequent section of the guidance has become redundant: "Where contractors have recharged the licensee for the primary purpose of performing direct activities which include costs for indirect activities but these are not explicitly costed in their invoice, all costs will be treated as direct. However, where the indirect activity is explicitly costed and detailed in their invoice this should be recorded against the relevant indirect activity".

g) Amend the Pass-through, Inflation update, and PCFM Input Summary tabs with the intent to now receive the relevant pass-through terms in nominal terms in the revenue sheets in the RRP. As such the 'Inflation update' tab is no longer needed. This results in necessary updates to the 'Pass-through' and 'PCFM Input Summary' sheet to ensure the nominal price base will be correctly read through in the 'PCFM input Summary' sheet.

h) Amending the definition of Totex to exclude certain legal costs.

i) Amending the AIP timeline to bring the publication date more in line with the tariff-setting date for Electricity Transmission networks.

Appendix 2 – Attachments

-  2022-23_RIIO-T2_Electricity_Transmission_RIGs_version 1.6_SPTComments...
-  ET2 RIGs SPT Comments.pdf
-  ET2 RIGs SPT Comments_TxGlossary.pdf
-  RIIO-ET2 RRP v2.2 SPTL_Comments.xlsx
-  T2_Transmission_Glossary_version 1.3_SPT Comments.pdf