

To:

Electricity Distribution, Gas  
Distribution, Gas  
Transmission, Electricity  
Transmission; Network  
Operators; and  
Stakeholders

Date: 5 June 2023

Dear Company Secretaries and Stakeholders,

**Decision to modify the special conditions of the Gas Transporter and Electricity Transmission licence and the Price Control Financial Instruments (PCFIs) for RIIO-GD2, RIIO-GT2 and RIIO-ET2**

On 14 April 2023 the Gas and Electricity Markets Authority (the 'Authority') gave notice<sup>1</sup> (the 'Notice') that it proposed to modify the special conditions of the Gas Transporter and Electricity Transmission licence.

The Notice stated that any representations on the modification proposals must be made on, or before 12 May 2023.

We<sup>2</sup> received nine responses to the Notice, which we have carefully considered. We received responses from three Gas Distribution Networks (GDNs), all three Electricity Transmission Operators (ETOs), National Gas Transmission (NGT), Citizen's Advice and Centrica. Non-confidential responses and our detailed responses to all comments are published on our website alongside this decision at "Issues log – PCFI and Licence Modifications".

Following the statutory consultation and our review of responses, we have decided to amend the special conditions and PCFIs and in particular the following documents for Gas Distribution, Gas Transmission and Electricity Transmission licensees:

- RIIO-GD2, RIIO-GT2 and RIIO-ET2 Price Control Financial Model (PCFM)
- RIIO-GD2, RIIO-GT2 and RIIO-ET2 Price Control Financial Handbook (PCFH)
- RIIO-GD2, RIIO-GT2 and RIIO-GT2 Special Conditions

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<sup>1</sup> <https://www.ofgem.gov.uk/publications/statutory-consultation-modify-price-control-financial-instruments-and-licence-conditions-gas-transmission-and-gas-distribution>

<sup>2</sup> References to 'the Authority', 'GEMA', 'Ofgem', 'we', 'us' and 'our' are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets. Ofgem is the office of the Authority which supports GEMA.

Please find enclosed the Decision letters setting out our changes issued pursuant to the relevant Licence Conditions and PCFIs for each relevant sector.

As part of the enclosed Decisions, we provide the following documents with the modifications [marked up]:

- RIIO-GD2 PCFM ;
- RIIO-GD2 PCFH: Version 1.4;
- RIIO-GT2 PCFM ;
- RIIO-GT2 PCFH: Version 1.3;
- RIIO-ET2 PCFM ;
- RIIO-ET2 PCFH: Version 1.3;
- Special Conditions of the Gas Transporter Licences for:
  - Cadent Gas Limited
  - Northern Gas Networks Limited
  - Southern Gas Networks plc
  - Scotland Gas Networks plc
  - Wales and West Utilities Limited
  - National Gas Transmission plc
- Special Conditions of the Electricity Transmission Licences for:
  - National Grid Electricity Transmission Plc
  - SP Transmission Plc
  - Scottish Hydro Electric Transmission Plc

## **The modifications**

Following our statutory consultation and review of responses, we have decided to make amendments to the PCFM, PCFH and Special Conditions. These include:

- Amending the Annual Iteration Process (AIP) timeline to bring the publication date in line with the tariff-setting date for gas distribution and transmission networks.
- Making updates to tax conditions in the PCFH and Special Conditions to align them with RIIO-ED2 and the language used in the Regulatory Financial Performance Reporting (RFPR) Guidance and template<sup>3</sup> and to provide clarifications

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<sup>3</sup> [Decision on the proposed modifications to the RIIO-2 Electricity Distribution licences | Ofgem](#)

- Modifying the RIIO-ET2 PCFM to include the new Accelerated Strategic Transmission Investment (ASTI) re-opener terms
- Re-stating the RIIO-GD2 non-variant allowances in the PCFM per the current consultation and amended cost models
- Modifying the FPNES Volume driver (special condition 3.14) and conversely VCMA (special condition 5.4)
- Modifying the unit costs of:
  - Commercial Fleet Price Control Deliverable (special condition 3.13)
  - Domestic Connections Volume Driver (special condition 3.15)

We set out the effect of and the reasons for these modifications below.

### **General updates**

We have also included other housekeeping updates and corrections to the Special Conditions and PCFIs. For further details on the updates and corrections please see the tracked changes within the documents published alongside this Decision.

We have therefore decided to modify the Special Conditions and PCFIs as proposed in the Notice relating to these general updates, and we have made various further housekeeping changes in the Special Conditions and PCFIs.

### **AIP timeline**

The following changes relate to our decision to amend the AIP timeline and process.

#### *AIP publication date*

The AIP is the process by which Ofgem recalculates network licensees' Allowed Revenues by updating the variable input values of the PCFM to reflect actual and updated forecast data, throughout each year of the price control. At the end of each AIP Ofgem publishes the value of Allowed Revenue for each licensee, which licensees must use when setting their network charges for the coming regulatory year.

In our statutory consultation we proposed a change to the AIP timeline to bring the publication date in line with the tariff-setting date for Electricity Transmission (ET) and Gas Distribution (GD) licensees (end of January) and closer to the tariff-setting date for Gas Transmission (GT). Whereas Ofgem currently publishes the AIP on 30 November with the opportunity for an additional AIP re-publication taking place by the end of January, we proposed to publish the AIP at the end of January only, which would mean no need for

an additional re-publication process for the ET and GD sectors.<sup>4</sup>

We received 6 responses regarding this proposal. 5 of these respondents were network companies and were supportive of this change to the AIP timelines. 1 respondent, Centrica, did not support the proposed changes noting that an early view of the PCFM in November is valuable to stakeholders and that the absence of this would result in reduced transparency over charges for suppliers.

Centrica stated "suppliers use the information provided in the Price Control Financial Model (PCFM) to forecast Use of System charges. The transparency provided by the November publication of the PCFM allows suppliers to review and take into consideration updated forecasts of network expenditure, re-opener allowances, volume driver allowances and incentive performance. These forecasts of Use of System charges are incorporated into retail tariff offerings to customers. Suppliers are therefore a key stakeholder in the AIP, and changes to the process will ultimately affect the retail tariffs faced by consumers."

We note that the reason for this proposal is to streamline the existing process, which over the past two years has required a publication of the PCFM in November, which was then superseded by an updated publication of the PCFM by 31 January, which is the tariff-setting date for GD/ET). The outcome over the past two years has been an effective two-month notice window for the PCFM and so we do not see this proposal as fundamentally changing what is happening in practice, rather it is a change to the administrative process around setting revenue.

Furthermore, we believe that this streamlining is beneficial for consumers; over the past two years there has been an increasing level of uncertainty within the energy market and in our view it is important for networks to be able to set their tariffs based on the most accurate and up-to-date data so that the charges consumers pay are cost-reflective. These proposals will encourage much-improved forecasting that will ultimately benefit consumers who will be paying tariffs that are more accurately calculated.

There is of course a necessary trade-off between flexibility and predictability. We appreciate that the publication of the November AIP PCFM was of value to Centrica for

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<sup>4</sup> For the GT sector, the re-publication process will remain in place, given the gas charging year has its own distinct timeline.

transparency and visibility reasons, regardless of the allowed revenue values within it. We would point out that network companies have an obligation to publish an indicative charging notice with a 150-day notice period. For the GD sector for instance, this is published in early November and contains much of the same information that would be found within the PCFM, which will continue to be available to suppliers and other stakeholders to provide an early view of charges.

Having said this, we understand through our further engagement with Centrica that its concerns are primarily around having early visibility of a PCFM. If there is material benefit in providing an early "dry run" of the PCFM around November or December in addition to the indicative charging notices that networks publish, then we may consider introducing a requirement for networks to publish an early, "draft" version of the PCFM on their websites so that stakeholders are able to see the indicative Allowed Revenue values before the final publication of the PCFM at the end of January.

This would require further consultation with networks, suppliers and other stakeholders to discuss the details and the preferred date of draft PCFM publication and is not something that can be introduced in this set of modifications. We think this would address the transparency concerns raised, while still enabling flexibility for the network companies to revise their forecasts for any material movements closer to the tariff-setting date.

We have therefore decided to modify the Special Conditions and PCFHs as proposed in the Notice, along with various housekeeping changes related to this. For further details on the updates and corrections please see the tracked changes within the documents and issues log published alongside this Decision.

#### *Materiality threshold for AIP January submission and re-publication*

In our statutory consultation we proposed an increase in the materiality threshold from 1% to 5% for the GT AIP re-publication process as well as the final GD PCFM submission at the end of the AIP.

We received 5 responses in relation to this modification. 3 GDNs, and NGT felt the increased materiality threshold was too high. 1 respondent, Centrica, felt that the increase to 5% was appropriate.

Following our review of these responses to our proposal to increase the materiality threshold from the existing level, we understand GDNs and NGT do not support a threshold of 5% on the basis of potential cashflow concerns among some GDNs and concerns around collecting materially incorrect revenues from customers. There was a strong preference to retain the 1% threshold.

Under the new AIP process and timelines, networks and Ofgem will have until mid-December to agree a final position for the PCFM, which is much later in the year than the previous regulatory information cut-off date of 30 October. As such we think networks should be able to provide better forecasts and indeed we think that raising the materiality thresholds will incentivise better forecasting earlier in the dry run process. This does not in any way infringe the best endeavours licence obligation, which requires that networks use their best estimate with the information available at the time of forecasting.

While we appreciate the GDNs' preference is for the 1% rate to remain to allow maximum flexibility in revising the PCFM, we need to balance this with balancing the needs of suppliers and other stakeholders, who we note through our engagement have a strong preference for a high materiality threshold and stability/predictability of charges. At the same time, we need to set up a process, which is both manageable in practice and takes into account the different tariff-setting dates of the different networks and there does need to be a practical cut-off point for changes to the values.

We have reviewed the magnitude of recent re-publication requests and consider a level of 3% an appropriate threshold which strikes the balance between capturing the most significant movements in allowed revenue but also is a threshold beneath which movements would not appear to cause any cashflow issues for networks. Our intention in increasing the threshold from the existing level is to incentivise networks to provide better forecasts earlier on in the revenue-setting process, but we recognise that there needs to be a process for any unforeseen changes to variable values, which are beyond the control of the networks and beyond their ability to forecast.

For all sectors, where any forecasts change between the AIP cut-off date and the tariff-setting date, changes that have not been captured by that cut-off date can and will be included in the following AIP, with a time value of money true-up applied to the difference.

We have therefore decided to modify the materiality threshold to 3% in the GD and GT PCFH from the materiality threshold of 5% we proposed in the Notice along with various housekeeping changes related to this change. For further details on the updates and corrections please see the tracked changes within the documents and issues log published alongside this Decision.

### **Tax review (Tax Allowance adjustment condition (SpC 2.2 and SpC 2.4) and Tax Reconciliation Assurance Statement Condition (SpC 9.8) and PCFH Chapter 6)**

We received 5 responses from network companies relating to our proposed modifications relating to the tax conditions and PCFH Chapter 6. These responses were supportive of the changes, and included further suggested minor amendments to the conditions for clarity, which we have implemented, and can be seen highlighted yellow in Schedule 1,2,3 and 4.

Following our review of these responses we have decided to modify the tax-related special conditions and Chapter 6 of the PCFH to align the language with that used elsewhere in our Regulatory Financial Performance Reporting guidance and templates.

The reason for this is to ensure that the terminology used throughout the licence, licence instruments and reporting guidance is consistent and to avoid any potential confusion for users of these documents.

The effect of this is to modify the text in the aforementioned special conditions and in Chapter 6 of the PCFH.

We have therefore decided to modify the licence as we proposed in the Notice, along with further minor clarifications and housekeeping changes.

### **Accelerated Strategic Transmission Investment (ASTI) re-opener terms**

We received three responses from ETOs relating to the ASTI re-opener terms that we proposed to be added into the ET2 PCFM. All respondents agreed with this modification.

We have decided to introduce two ASTI related re-opener terms into the RIIO-ET2 PCFM, and following responses have also included these terms in Table 2.1 of the ET2 PCFH.

The reason for this is due to the recently closed Accelerated Strategic Transmission Investment Informal Licence Drafting Consultation<sup>5</sup> which contains drafting for two ASTI related re-opener terms, and to ensure the RIIO-ET2 PCFM aligns with this.

The effect of this is to modify the RIIO-ET2 PCFM, and add in two line items for the two re-opener terms:

- Accelerated strategic transmission investment Pre-Construction Funding Re-opener (APCF<sub>t</sub>); and
- ASTI re-opener term Accelerated strategic transmission investment Re-opener (ASTIR<sub>t</sub>).

We have decided to modify the licence as we proposed in the Notice, without further changes.

### **Re-stating the Non-Variant Allowances in the RIIO-GD2 PCFM**

We received one response relating to re-stating the Non-Variant Allowances in the RIIO-GD2 PCFM that we proposed. All respondents agreed with this modification.

We have addressed certain concerns pertaining to the Non-Variant Allowances in RIIO GD2 following the first year of reporting the AIP.

The reason for this is to update and correct figures within the PCFM.

The effect of this is to modify the non-variant totex allowance line items in the RIIO-GD2 PCFM in each licensee input sheet.

We have decided to modify the licence as we proposed in the Notice, without further changes.

### **Modify the FPNES volume driver (Special condition 3.14) and the VCMA (Special condition 5.4).**

We received five responses relating to modifying the FPNES volume driver and the VCMA

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<sup>5</sup> [Accelerated Strategic Transmission Investment Informal Licence Drafting Consultation | Ofgem](#)



that we proposed. Two respondents agreed with this modification.

Three responses raised points in relation to the amount of funding being modified, the governance and company strategies to deliver for vulnerable consumers. Ofgem clarified that the governance and controls currently within the VCMA Governance Document need to be adapted due to the increase in funding which is being reallocated. As such, there is a plan to further improve the level of detail provided in the GDNs Annual Report for VCMA, enhance the control measures within the governance framework, update the GDNs strategies for the VCMA to ensure they are adequately meeting consumers' needs, standardised reporting and methodologies for Societal Return on Investment (SROI) to ensure a consistent and transparent review of each GDNs activity in this area. Therefore, we believe these additional elements will provide the assurances that GDNs are adapting to meet the current needs of consumers and that the outputs are consistently reported in an easily comparable fashion.

We are repurposing unspent FPNES allowances into the VCMA.

The reason for this is to enable GDNs to utilise unspent allowance in order to support vulnerable consumers.

The effect of this is to modify FPNES and VCMA allowances in order to provide additional support to vulnerable consumers.

We have decided to modify the licence as we proposed in the Notice, without further changes.

### **Modify the Commercial Fleet Price Control Deliverable (Special condition 3.13)**

We received three responses relating to modifying the Commercial Fleet PCD that we proposed. Two respondents agreed with this modification.

One respondent wanted clarity on whether the expansion of different vehicle types enabled flexibility in how GDNs can meet their deliverables. Ofgem have discussed this with stakeholders in working groups and reiterate that we support this, as long as GDNs can show that the vehicle types are meeting the operational needs of the business.

We have expanded the range of Electric Vehicle (EV) categories that are eligible under the PCD so that all GDNs have consistent options available to them and their associated unit costs.

The reason for this is to allow each GDN the same options of Electric Vehicles categories under the PCD.

The effect of this is to modify expand the EV categories and unit costs within the Commercial Fleet PCD.

We have decided to modify the licence as we proposed in the Notice, without further changes.

### **Modify the Domestic Connections Volume Driver (Special condition 3.15)**

We received three responses relating to modifying the Domestic Connections volume driver that we proposed. Two respondents agreed with this modification.

One respondent wanted clarification in relation to the cost basis for unit costs. Ofgem clarified that the same process and calculations have been followed in comparison to historic models. The only change which occurred was the reportioning of Design and Quotation costs.

We have made a correction to the unit costs for the Domestic Connections Volume Driver.

The reason for this is to update the unit costs for Domestic Connections after appropriately reallocating costs based on the workload breakdown between mains and service connections.

The effect of this is to modify the unit costs of the Domestic Connections Volume Driver.

All of the modifications have been discussed with licensees during working groups and we have considered any views expressed and representations made, as per the requirements of Special Condition 8.1.

For further details on changes to the PCFM and PCFH please refer to Appendix 2 and Appendix 3. These changes can also be seen in the tracked changes within the documents.

This decision will take effect from 31<sup>st</sup> July 2023.

Yours faithfully,

**Mick Watson**

**Deputy Director**

**Chief Financial Advisor**

**Duly authorised on behalf of the Authority**

**To:**

**Cadent Gas Limited  
Northern Gas Networks Limited  
Scotland Gas Networks plc  
Southern Gas Networks plc  
Wales and West Utilities Limited  
National Gas Transmission Plc – 02006000**

**Gas Act 1986  
Section 23(1)(a)**

**Modification of the special conditions of the Gas Transporter licence held by the licensees listed above**

1. Each of the licensees to whom this document is addressed is the holder of a Gas Transporter Licence ('the Licence') granted or treated as granted under section 7 of the Gas Act 1986 ('the Act').
2. Under section 23(2) of the Act, the Gas and Electricity Markets Authority (the 'Authority') gave notice<sup>6</sup> on 14 April 2023 (the 'Notice') that it proposed to modify the special conditions of the Gas Transporter licence. We stated that any representations to the modification proposal must be made on or before 12 May 2023.
3. A copy of the Notice was sent to the Secretary of State in accordance with section 23(4)(b) of the Act, and we have not received a direction that the changes should not be made.
4. We received nine responses to the Notice, which we have carefully considered. Non-confidential responses and our response to these comments are published on our website at "Issues log – PCFI and Licence Modifications".
5. The purpose, reasons for, and effect of these modifications are described in the cover letter to this direction.
6. Schedule 1 to this notice contains the modifications to the special conditions of the Gas Transporter licence held by National Gas Transmission Plc<sup>7</sup>. Schedule 2 to notice contains the modifications to the special conditions of the Gas Transporter Licence held by Cadent Gas Limited, Northern Gas Networks Limited, Southern Gas Networks plc, Scotland Gas Networks plc, and Wales and West Utilities Limited.
7. In addition, we are modifying the GT2 and GD2 Price Control Financial Instruments (PCFIs).

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<sup>6</sup> <https://www.ofgem.gov.uk/publications/statutory-consultation-modify-price-control-financial-instruments-and-licence-conditions-gas-transmission-and-gas-distribution>

<sup>7</sup> Company number 02006000

8. The reasons for these modifications, and an overview of the modifications being made to both the GT2 and GD2 Price Control Financial Models (PCFM) are set out below:
  - a. to align the PCFM inputs with the inputs to the Regulatory Instructions and Guidance (RIGs) reporting we have updated the price base of certain pass-through terms to nominal from 18/19 prices.
9. There are some modifications that relate to the GD2 PCFM only. The reasons for and overviews of the modifications are set out below:
  - a. we have amended the yellow-box non-variant allowances in the licensee input sheets for each licensee. The reasons and effect can be seen in the covering letter to this direction;
  - b. we have amended the "SavedResults" sheet to enable the correct calculations on the AR sheet to split Allowed Revenue into the three sub-components that gas distribution licensees need to input into their charging model. This was previously done offline and so licensees requested that we include the calculation in the PCFM to automate this process. This split is for presentational purposes only and has no impact on the calculation of Allowed Revenue; and
  - c. we have added a label for the SIU cross-subsidy adjustment for clarity.
10. There are some modifications that relate to the GT2 PCFM only. The reasons for and overviews of the modifications are set out below:
  - a. we have corrected a formula that checks the totex allocations rates sum to 100%;
  - b. we have corrected a formula to link to the assumed cost multiplier to the Strategic Innovation Fund (SIF<sub>t</sub>); and
  - c. we have corrected the assumed cost multiplier value for SIF<sub>t</sub> to 100% from 111.11%.
11. Please see Appendix 2 to this direction for a list of the PCFM modifications.
12. The reasons and effect of the modifications for the GT2 and GD2 PCFH can be seen in the covering letter to this direction. An overview of the modifications being made to both the GT2 and GD2 Price Control Financial Handbook (PCFH) are set out below:
  - a. Amending the AIP timeline to bring the publication date in line with the tariff-setting date for gas distribution and transmission networks; and
  - b. Amending Chapter 6 (Tax liability allowances) to align with the equivalent chapter in the RIIO-ED2 PCFH and the language used in the Regulatory Financial Performance Reporting (RFPR) Guidance and template<sup>8</sup>.
13. Please see Appendix 3 to this direction for a list of the PCFH modifications.

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<sup>8</sup> [Decision on the proposed modifications to the RIIO-2 Electricity Distribution licences | Ofgem](#)

14. Having carefully considered the responses received to the Notice, we have decided to proceed with the modifications to the Special Licence Conditions and the GD2 and GT2 PCFIs set out in the Notice, with a number of alterations to reflect the feedback in the responses received. These alterations are highlighted in yellow in the modified Special Licence Conditions, and the GD2 and GT2 Price Control Financial Instruments as shown in Schedule 1, 4 and 5.
15. Where an application for permission to appeal our decision is made to the Competition and Markets Authority (CMA) under section 23B of the Act, Rule 5.7 of the Energy Licence Modification Appeals: Competition and Markets Authority Rules<sup>9</sup> requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-sensitive notice setting out the matters required in Rule 5.2. Section 23(10) of the Act sets out the meaning of 'relevant licence holder'.
16. Under the powers set out in section 23(1)(a) of the Act, we hereby modify the GD2 and GT2 Price Control Financial Instruments and the Special Licence Conditions of the Gas Transporter Licence of the licensees in the manner specified in Schedule 1, 4 and 5. This decision will take effect from 31 July 2023.
17. This document is notice of the reasons for the decision to modify the gas transporter licence held by the licensees as listed above as required by section 38A of the Act.
18. A copy of the modifications and other documents referred to in this document have been published on our website ([www.ofgem.gov.uk](https://www.ofgem.gov.uk)). Alternatively they are available from [foi@ofgem.gov.uk](mailto:foi@ofgem.gov.uk).

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**Mick Watson**  
**Deputy Director**  
**Chief Financial Advisor**  
**Duly authorised on behalf of the Gas and Electricity Markets Authority**  
**05 June 2023**

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<sup>9</sup> CMA70 [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/655601/energy-licence-modification-appeals-rules.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655601/energy-licence-modification-appeals-rules.pdf)

**To:**

**Scottish Hydro Electric Transmission plc  
SP Transmission Ltd  
National Grid Electricity Transmission plc**

**Electricity Act 1989  
Section 11A(1)(a)**

**Modification of the special conditions of the Electricity Transmission licence  
held by the licensees listed above**

1. Each of the licensees to whom this document is addressed is the holder of a Electricity Transmission Licence ('the Licence') granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 ('the Act').
2. Under section 11A(2) of the Act, the Gas and Electricity Markets Authority (the 'Authority' ) gave notice<sup>10</sup> on 14 April 2023 (the 'Notice') that it proposed to modify the special conditions of the Electricity Transmission licence. We stated that any representations to the modification proposal must be made on or before 12 May 2023.
3. A copy of the Notice was sent to the Secretary of State in accordance with section 11A(4)(b) of the Act, and we have not received a direction that the changes should not be made.
4. We received nine responses to the Notice, which we have carefully considered. Non-confidential responses and our response to these comments are published on our website at "Issues log – PCFI and Licence Modifications".
5. The purpose, reasons for, and effect of these modifications are described in the cover letter to this direction.
6. Schedule 3 to this notice contains the modifications to the special conditions of the Electricity Transmission licence held by Scottish Hydro Electric Transmission plc, SP Transmission Ltd and National Grid Electricity Transmission plc.
7. In addition, we are modifying the ET2 Price Control Financial Instruments (PCFIs).
8. The reasons for these modifications, and an overview of the modifications being made to the ET2 Price Control Financial Model (PCFM) are set out below:
  - a. to align the PCFM inputs with the inputs to the Regulatory Instructions and Guidance (RIGs) reporting we have updated the price base of certain pass-through terms to nominal from 18/19 prices.
9. There are some modifications that relate to the ET2 PCFM only. The reasons for and overviews of the modifications are set out below:

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<sup>10</sup> <https://www.ofgem.gov.uk/publications/statutory-consultation-modify-price-control-financial-instruments-and-licence-conditions-gas-transmission-and-gas-distribution>

- a. we have added re-opener PCFM Variable Value line items to each licensee input sheet in-line with the Accelerated Strategic Transmission Investment (ASTI) Informal Licence Drafting Consultation.<sup>11</sup>
10. Please see Appendix 2 to this direction for a list of the PCFM modifications.
11. The reasons and effect of the modifications for the ET2 PCFH can be seen in the covering letter to this notice. An overview of the modifications being made to the ET2 Price Control Financial Handbook (PCFH) are set out below:
  - a. Amending the AIP timeline to bring the publication date in line with the tariff-setting date for transmission networks; and
  - b. Amending Chapter 6 (Tax liability allowances) to align with the equivalent chapter in the RIIO-ED2 PCFH and the language used in the Regulatory Financial Performance Reporting (RFPR) Guidance and template<sup>12</sup>.
12. Please see Appendix 3 to this direction for a list of the PCFH modifications.
13. Having carefully considered the responses received to the Notice, we have decided to proceed with the modifications to the Special Licence Conditions and the ET2 PCFIs set out in the Notice, with a number of alterations to reflect the feedback in the responses received. These alterations are highlighted in yellow in the modified Special Licence Conditions, and the ET2 Price Control Financial Instruments as shown in Schedule 3,4 and5.
14. Where an application for permission to appeal our decision is made to the Competition and Markets Authority (CMA) under section 11C of the Act, Rule 5.7 of the Energy Licence Modification Appeals: Competition and Markets Authority Rules<sup>13</sup> requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-sensitive notice setting out the matters required in Rule 5.2. Section 11A(10) of the Act sets out the meaning of 'relevant licence holder'.
15. Under the powers set out in section 11A(1)(a) of the Act, we hereby modify the ET2 Price Control Financial Instruments and the Special Licence Conditions of the Electricity Transmission Licence of the licensees in the manner specified in Schedule 3,4 and 5. This decision will take effect from 31 July 2023.
16. This document is notice of the reasons for the decision to modify the electricity transmission licence held by the licensees as listed above as required by section 49A(2) of the Act.

<sup>11</sup> [Accelerated Strategic Transmission Investment Informal Licence Drafting Consultation | Ofgem](#)

<sup>12</sup> [Decision on the proposed modifications to the RIIO-2 Electricity Distribution licences | Ofgem](#)

<sup>13</sup> CMA70 [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/655601/energy-licence-modification-appeals-rules.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655601/energy-licence-modification-appeals-rules.pdf)



17. A copy of the modifications and other documents referred to in this document have been published on our website ([www.ofgem.gov.uk](http://www.ofgem.gov.uk)). Alternatively they are available from [foi@ofgem.gov.uk](mailto:foi@ofgem.gov.uk).

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**Mick Watson**

**Deputy Director**

**Chief Financial Advisor**

**Duly authorised on behalf of the Gas and Electricity Markets Authority**

**05 June 2023**

## **Appendix 1 – Updates to the RIIO-GD2 Special Conditions**

The Special Conditions containing the modifications are attached as schedules to this decision detailing changes to the FPNES & VCMA; Commercial Fleet Price Control Deliverable & the Domestic Connections Volume Driver.

### **Part A: Repurposing the FPNES to the VCMA**

FPNES connection targets have been revised downwards for several reasons; a shift in policy towards renewable energy and reducing carbon emissions, the recent rise in energy prices, and operational issues. Through discussions with Gas Distribution Networks (GDNs) and relevant consumer groups, Ofgem has decided to re-purpose some unspent GDNs FPNES allowances to support Vulnerable consumers.

To achieve this, we have used GDNs' connection forecasts and allowed for some flexibility in over-delivery. Then, using the remaining funding we have applied the same methodology used in Final Determinations to allocate each GDN a share of the VCMA total funding pot.

We are continuing to work together with GDNs and consumer groups to update the VCMA Governance document. We have a plan to further improve the level of detail provided, enhance the control measures within the governance framework, update the GDNs strategies for the VCMA to ensure they are adequately meeting consumers' needs, standardise reporting and methodologies for Societal Return on Investment to ensure a consistent and transparent review of each GDNs activity in this area. To enable GDNs to further support vulnerable consumers this coming winter, we have facilitated the repurposing of allowances ahead of the updates for the governance document.

### **Part B: Commercial Fleet Price Control Deliverable**

As a result of current global supply issues and the fact that certain types of Electric Vehicles may not be appropriate for the GDNs specific requirements, we have made the decision to expand the range of vehicle categories that are eligible under the PCD so each GDN has consistent options available to them.

### **Part C: Domestic Connections Volume Driver**

Following some corrections to the modelling process, some adjustments were required to ensure accurate unit costs were used in this mechanism. As such, costs have been reallocated based on workload breakdown specifically between 'Mains' and 'Services' to produce updated and accurate unit cost values.

## **Appendix 2 – Changes to the RIIIO-2 Price Control Financial Models (PCFMs)**

The PCFMs containing the modifications are attached as schedules to this decision. The changes have been highlighted with red borders. A summary of the changes follows below.

### **Part A: Changes to the price base of pass-through terms in the PCFM for GD, GT and ET**

The modifications made to the PCFM for all sectors are as follows:

- Amended the price base of numerous pass-through costs for all licensee input sheets in the "Units" column to "£m nominal";
- Where relevant converted the pass-through blue-box values to £m nominal in the licensee input sheets; and
- Amended the formula in the "Input" and "SystemOperator" sheet to convert the relevant pass-through cost line items to £m 18/19 prices, now that they are recorded as £m nominal in the licensee input sheets.

### **Part B: Addition of the ASTI re-opener licence terms in the ET2 PCFM**

The modifications made to the ET2 PCFM are as follows:

- Inserted a row in all licensee input sheets for the new ASTI re-opener term Accelerated strategic transmission investment Pre-Construction Funding Re-opener (APCF<sub>t</sub>); and
- Inserted a row in all licensee input sheets for the new ASTI re-opener term Accelerated strategic transmission investment Re-opener (ASTIR<sub>t</sub>).

### **Part C: Formula corrections and general housekeeping in the GT2 PCFM**

The modifications made to the GT2 PCFM are as follows:

- In the "NGGT TO" sheet, added a formula in row 154 to sum the totex allocations rates in order to check the output is 100%;
- In the "Input" sheet amended the formula in cell I107 to ensure it is correctly linked to the assumed cost multiplier for the Strategic Innovation Fund (SIF<sub>t</sub>) in the "NGGT TO" sheet, cell AP77; and
- In the "NGGT TO" sheet, corrected the value in cell AP77, the assumed cost multiplier of SIF<sub>t</sub>, to 100% from 111.11%

### **Part D: Amendment to the non-variant allowances and general housekeeping in the GD2 PCFM**

The modifications made to the GD2 PCFM are as follows:

- Amended the non-variant allowances in each of the licensee input sheets;
- Added a term label for the cross-subsidy line item (WWUACPt and SGNACPt) in

- row 481 in the 'Wales & West' and 'Scotland' sheets respectively;and
- We have changed the Exit and SOLR Calculated Revenue, and Exit and SOLR ADJ line items to blue box inputs in the "SavedResults" sheet to enable the correct calculations on the AR sheet to split Allowed Revenue into the three sub-components that gas distribution licensees need to input into their charging model. This was previously done offline and so licensees requested that we include the calculation in the PCFM to automate this process. This split is for presentational purposes only and has no impact on the calculation of Allowed Revenue.

### **Appendix 3 – Changes to the RIIO-2 Price Control Financial Handbooks (PCFHs)**

The PCFHs containing the modifications are attached as schedules to this decision. The changes are tracked. A summary of the changes and where they appear follows below.

#### **Part A: Amending the AIP timeline for GD, GT and ET**

The modifications to the PCFHs can be seen in the attached schedules. Throughout the PCFH we have made adjustments to dates to account for the amended AIP timeline

The modifications made to the PCFH can be seen in:

- Chapter 2 "The RIIO-[XX]2<sup>14</sup> PCFM and the Annual Iteration Process"
- Chapter 4 "Cost of debt and cost of equity indexation"
- Chapter 5 "Real Price Effects"
- Chapter 6 "Tax Liability Allowances"

#### **Part B: Updating Chapter 6 to align with RIIO-ED2 and RFPR Guidance and template for GD, GT and ET**

In the tax chapter we have made updates to align the language with RIIO-ED2 and the language used in the Regulatory Financial Performance Reporting (RFPR) Guidance and template.<sup>15</sup>

The modifications made to the PCFH can be seen in:

- Chapter 6 "Tax Liability Allowances"

#### **Part C: General Housekeeping for GD, GT and ET**

Throughout the PCFHs we have made amendments for general housekeeping purposes to improve clarity and additional detail where needed.

The modifications made to the PCFH can be seen in:

- Chapter 2 "The RIIO-XX2 PCFM and the Annual Iteration Process"
- Chapter 4 "Cost of debt and cost of equity indexation"
- Chapter 5 "Real Price Effects"
- Chapter 6 "Tax Liability Allowances"

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<sup>14</sup>'ET2', 'GT2' and 'GD2'

<sup>15</sup> [Decision on the proposed modifications to the RIIO-2 Electricity Distribution licences | Ofgem](#)