

To:

Electricity Distribution  
Network Operators; and  
Stakeholders

Date: 02 June 2023

Dear Company Secretaries and Stakeholders,

## **Proposal to modify the RIIO-2 Electricity Distribution Price Control Financial Instruments**

We propose to make modifications to:

- RIIO-ED2 Price Control Financial Model
- RIIO-ED2 Price Control Financial Handbook

Please find enclosed the Notice setting out our proposed changes issued pursuant to the relevant Licence Conditions for the sector.

### **Proposed modifications**

In accordance with Special Condition 8.1 of the Electricity Distribution Licence Special Conditions, we are consulting on the proposed modifications to the RIIO ED2 Price Control Financial Instruments:

- Relabelling of cells within Price Control Financial Model and the related terms in the Price Control Financial Handbook
- Relabelling of terms and related text within the Price Control Financial Handbook
- Removing redundant text within the Price Control Financial Handbook
- Removing redundant data, rows, and columns within the Price Control Financial Model
- Correcting an error in the formula for the Recovered Revenue Forecasting Penalty calculation within the Price Control Financial Model
- Adjusting the general and special rate tax pool opening balances and tax paid calculation in the PCFM to reflect the impact of the introduction of the temporary capital allowances scheme announced in the Spring Budget 2023

These modifications have been proposed to address issues raised through the ED2 RIGs and ED2 modelling working groups. It is our view that these changes do not constitute a significant modification under SC 8.1 as they serve to correct manifest errors in the PCFM and PCFH.

## **Timeline**

If we implement these proposed modifications, they will take effect from 1 July 2023.

We welcome representations on our proposed modifications by 28 June, and the details for responding are contained in the enclosed Proposed Direction.

Yours faithfully,

**Mick Watson**

**Chief Financial Advisor, Analysis and Assurance**

**Duly authorised on behalf of the Authority**

**02 June 2023**

**Electricity North West Ltd (ENWL)**  
**Northern Powergrid (Northeast) Ltd (NPgN)**  
**Northern Powergrid (Yorkshire) plc (NPgY) London**  
**Power Networks plc (LPN)**  
**South Eastern Power Networks plc (SPN) Eastern**  
**Power Networks plc (EPN)**  
**SP Distribution plc (SPD)**  
**SP Manweb plc (SPMW)**  
**Scottish Hydro Electric Power Distribution plc (SSEH)**  
**Southern Electric Power Distribution plc (SSES)**  
**National Grid Electricity Distribution (West Midlands) plc (WMID)**  
**National Grid Electricity Distribution (East Midlands) plc (EMID)**  
**National Grid Electricity Distribution (South Wales) plc (SWALES)**  
**National Grid Electricity Distribution (South West) plc (SWEST)**  
(each one a "Licensee," and together, "the Licensees")

**Proposed direction under Part C of Special Condition 8.1 (Governance of the ED2 Price Control Financial Instruments) of the Electricity Distribution Licence to make modifications to the ED2 Price Control Financial Instruments**

1. Each of the companies to whom this proposed direction is addressed (each "the licensee") is the holder of an Electricity Distribution Licence granted or treated as granted under section 6(1)(c) of the Electricity Act 1989
2. Special Condition ("SC") 8.1 (Governance of ED2 Price Control Financial Instruments) of the Electricity Distribution Licence provides that the Gas and Electricity Markets Authority ("the Authority")<sup>1</sup> may direct a modification to the ED2 Price Control Financial Instruments ("the PCFI") where:
  - a. it becomes aware of a modification that will improve the functionality or clarity of the ED2 Price Control Financial Instruments; and
  - b. the modification will have no impact on the licensee's Allowed Revenue.
3. In accordance with Part B of SC 8.1, the Authority has conducted an assessment of the likely impact of intended PCFI modifications. The Authority is satisfied, having regard to the views of the [ED2] Price Control Financial Model Working Group, the proposed PCFI modifications, as set out above, serve to correct manifest errors in the PCFI. As a result, and in accordance with SC 8.1.5, the Authority intends to modify the PCFI by direction.

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<sup>1</sup> The "Authority," "Ofgem," "we" and "our" are used interchangeably in this document. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work.

4. In accordance with SC 8.1.7 the Authority hereby gives notice to the licensees addressed above that it proposes to modify the PCFI in the manner indicated in the Appendices at the end of this Notice.
5. On 02 June 2023 the Authority published the text of the proposed direction on the Authority's website and requested that any representations were made by email to david.simpson@ofgem.gov.uk. The reason for the proposed modifications is to correct errors in the PCFI and the effects of these proposed modifications are set out in the appendices to this notice.
6. We received [number] representations and have placed all non-confidential representations on our website. We have considered those representations and decided to proceed with making this direction. Our response to those representations can be found at [completed issues log].
7. [Changes since the proposed direction]
8. This direction is our notice of reasons for the purposes of section 49A of the Electricity Act 1989.
9. The Authority hereby directs the modifications to the PCFI set out in the Annexes to this direction. Appendices 1 and 2 indicate the location of these changes within the Annexes. These modifications will come into effect on 01 July 2023.

**Mick Watson**  
**Chief Financial Advisor, Analysis and Assurance**  
**Duly authorised on behalf of the Authority**  
**02 June 2023**

## Appendix 1 – Location of modifications within the Price Control Financial Model

Nature of Modification	Sheet Reference	Cell reference
Forecasting penalty calculation – years prior to 26/27 have been deleted as PCFM guidance states: "For Regulatory Years commencing prior to 1 April 2026, the value of $FP_t$ is zero."	AR Tab	AR89:AT89 AR103:AT103 AR105:AT105
RR <sub>t</sub> is mislabelled on the input tab row 265 and input summary tab (row 248). Input summary row 249 is performing the <i>calculation</i> of recovered revenue per SpC 2.1.7, which is then used in the AR tab for recovered revenue. This will have the effect of double counting bad debt if the definition of RR <sub>t</sub> is entered in the input tab. In order to correct: The formula in InputSummary row 248 has been copied to the right (AS:AV) InputSummary Cell E248: "Revenue as billed (ignoring bad debt)" And H248 set to BILLR <sub>t</sub> . InputSummary Cell e249: label changed to "Recovered Revenue" and H249 set to RR <sub>t</sub> Selected Inputs and all licensee input tabs: E265 and H265: Changed label "Revenue as billed (ignoring bad debt)" and "BILLR <sub>t</sub> "	Input Summary Tab  Input Tabs	Row 248, cells E248,H248, E249, H249 AS248-AV248  E265, H265
TIM tab rows 78 to 124 ( the "Adjustments for Financial Statements" section) are redundant and have been deleted. They are leftovers from the fuller analytical version of the model.	TIM Tab	Rows 78:124
There is an error in the formula for the Recovered Revenue Forecasting Penalty calculation on the AR tab. Cell AR103, formula changed from " $=(AQ62 - AQ95) * AQ97 * AQ101$ " to " $=(AQ62 - AQ94) * AQ97 * AQ101$ "and copy this formula to cells AS103 to AV103.	AR Tab	Column AQ
The UserInterface tab contains redundant ED1 data: cells G13:G27 list whether companies are ED1 slow track or fast track. These have been deleted. Additionally, the group information in F13:F27 has been deleted.	User Interface Tab	G13:G27 F13:F27
The general and special rate tax pool opening balances require adjusting to reflect the impact of the introduction of the temporary capital allowances scheme announced in the Spring Budget 2023  On the licensee-specific input sheets and the 'selectinput' sheet, we have added blue box rows in the input sheets to enable opening balance adjustments for these general and special rate tax pools. These rows are 'General Pool Opening Balance Adjustment' and 'Special Rate Pool Opening Balance Adjustment'.	DNO Input Sheets SelectInputs Sheet  DNO Input Sheets SelectInputs Sheet	   E283:AV283 E284: AV284

On the 'TaxPools' sheet new revisions rows have been added under general and special pools. These 'Revisions' rows are linked to the new 'General Pool Opening Balance Adjustment' and 'Special Rate Pool Opening Balance Adjustment' rows on the 'selectinputsheet'.	TaxPools	E64:AV64 E77:AV77
To allow for the impact of the super deduction tax regime to be reflected we have updated the tax paid calculation within the 'Finance&Tax' sheet.  We have added 'Contributions to losses from clawback' and 'Adjustments to losses from tax trigger' in the tax paid calculation.  We have updated the formula in the 'profits reduced by tax losses' row to account for these new rows	Finance&Tax	E264:AV264 E265:AV265  AR266:AV266

## Appendix 2 – Location of modifications within the Price Control Financial Handbook

Nature of Modification	Reference	Page number
PCFH table 3.1 has been altered to change the $RR_t$ variable value to be $BILLR_t$	Table 3.1	23
PCFH table 3.1 has been altered to add terms for General pool and Special Rate pool opening balance adjustments	Table 3.1	23
PCFH paragraph 6.3 has been altered to add supplementary wording relating to the addition of the opening pool balance adjustments variable values.	Paragraph 6.3	36
PCFH paragraph 1.4 has been altered to clarify that RIGS and PCFM Guidance are Associated Documents	Paragraph 1.4 c	4
PCFH paragraph 3.14 has been altered to replace the $RPE_t$ term and related text with $RPEI_t$ . $RPE_t$ is not a variable value, this should be $RPEI_t$ .	Paragraph 3.14 c	15
PCFH paragraphs 5.2 and 5.3 have been altered to confirm the status of terms $RPE_t$ and $RPI_t$ . $RPE_t$ is not a variable value, $RPEI_t$ is a variable value which is rounded to four decimal places.	Paragraphs 5.2 & 5.3	31
PCFH paragraph 5.7 has been altered to remove the reference to the PCFM in the calculation of $RPE_t$ as the $RPE_t$ values are calculated in the RPE workbook and then copy and pasted as hardcoded values into the PCFM.	Paragraph 5.7	33

PCFH paragraphs 5.19 and 5.20 plus subheading – RPE <sub>t</sub> term has been replaced with RPEI <sub>t</sub> as these paragraphs should refer to RPEI <sub>t</sub>	Paragraphs 5.19 & 5.20	35
PCFH paragraph 7.38 – word “or” has been removed as all criteria listed should be met	Paragraph 7.38 c	56
PCFH paragraph 8.4 c – words “Set the” removed as these are redundant	Paragraph 8.4 c	65
PCFH paragraph 2.8 – text around the timing of the OBR outlook has been altered: “as at 30 November” replaced with “during November” . Ofgem intends to reflect the Autumn OBR update, however, this may not be possible if the update occurs on 30 <sup>th</sup> November.	Paragraph 2.8	7