

To:

Electricity Distribution
Network Operators; and
Stakeholders

Date: 08 September 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

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 Model:

- Correcting an error in the formula used to determine whether Cap rate 2 calculations use allowance or forecast/actual values.
- Correcting the calculations for the allocation of actual Totex to the capital allowance pools.

These modifications have been proposed to address issues raised through the 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.

Timeline

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

We welcome representations on our proposed modifications by 06 October, 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

08 September 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")¹ 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.

¹ 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 08 September 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] <mailto:david.simpson@ofgem.gov.uk>
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 Annex to this direction. Appendix 1 indicates the location of these changes within the Annex. 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
08 September 2023

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

Nature of Modification	Sheet Reference	Cell reference
<p>In row 62 of the "Totex" worksheet tab, there is a switch which decides whether allowance or forecast/actuals are used. In the instance of there being negative Cap rate 2 actual expenditure, the switch will not be activated since it is dependent on the sum of the actuals for cap rate 2 being >0.</p> <p>Changes:</p> <p>Totex tab, cell changed AR62 from <code>=IF(SUM(InputSummary!AR72:InputSummary!AR78)>0,1,0)</code> to <code>=IF(SUM(InputSummary!AR72:InputSummary!AR78)<>0,1,0).</code> Formula copy/pasted across AS62:AV62</p>	Totex worksheet tab	AR62:AV62
<p>Allocations of totex to each capital allowance pool are currently made on the basis of allowed totex instead of actual totex. To amend this, <i>TaxPools</i> rows 38-43 are replaced with the following:</p> <p>Row 38 (allocation to General pool): <code>=SUMPRODUCT(AR\$22:AR\$28,InputSummary!AR436:AR442)/SUM(Totex!AR\$75:AR\$81)</code></p> <p>Row 39 (allocation to Special Rate pool): <code>=SUMPRODUCT(AR\$22:AR\$28,InputSummary!AR443:AR449)/SUM(Totex!AR\$75:AR\$81)</code></p> <p>Row 40 (allocation to Deferred Revenue pool): <code>=SUMPRODUCT(AR\$22:AR\$28,InputSummary!AR450:AR456)/SUM(Totex!AR\$75:AR\$81)</code></p> <p>Row 41 (allocation to Structures and Buildings pool): <code>=SUMPRODUCT(AR\$22:AR\$28,InputSummary!AR457:AR463)/SUM(Totex!AR\$75:AR\$81)</code></p> <p>Row 42 (allocation to Revenue pool): <code>=SUMPRODUCT(AR\$22:AR\$28,InputSummary!AR464:AR470)/SUM(Totex!AR\$75:AR\$81)</code></p> <p>Row 43 (allocation to Non Qualifying pool): <code>=SUMPRODUCT(AR\$22:AR\$28,InputSummary!AR471:AR477)/SUM(Totex!AR\$75:AR\$81)</code></p> <p><i>InputSummary</i> rows 290-297 & 339-354, and <i>Checks</i> row 14 are now redundant and have been deleted.</p>	<p>TaxPools worksheet</p> <p><i>InputSummary</i> worksheet</p> <p><i>Checks</i> worksheet</p>	<p>Rows 38-43</p> <p>Rows 290-297 Rows 339-354</p> <p>Row 14</p>