

To:

Electricity Transmission;
Network Operators; and
Stakeholders

Date: 02 May 2024

Dear Company Secretaries and Stakeholders,

Decision to modify the Electricity Transmission Regulatory Instructions and Guidance ("RIGs"), the Regulatory Reporting Pack ("RRP") and the Price Control Financial Model ("PCFM") Guidance for RIIO-2

We¹ are issuing directions under the RIGs and in particular in relation to the following documents for Electricity Transmission licensees:

- RIIO-ET2 RRP data templates
- RIIO-ET2 RIGs documents
- RIIO-ET2 PCFM Guidance

We are also issuing directions under Special Condition 8.2 (Annual Iteration Process for the Price Control Financial Model) in relation to the PCFM Guidance for Electricity Transmission licensees.

Please find enclosed the Directions setting out our changes made pursuant to the relevant Licence Conditions.

RIGs and RRP

The RIGs and RRP, are the principal means by which we collect cost, volume, allowed expenditure and output delivery information from licensees to monitor performance against their RIIO-2 objectives and hold them to account.

As part of the enclosed Directions, we provide the modified versions of the following

¹ 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.

documents [clean and marked up versions]:

- RIIO-ET2 Regulatory Instructions and Guidance: Version 1.8;
- RIIO-ET2 Regulatory Reporting template: Version 2.5;
- RIIO-ET2 PCFM Guidance: Version 1.3;

Decision

We have decided to make a number of modifications to the RIGs, RRP and to the PCFM Guidance to align them with the RIIO-2 special licence conditions, the Price Control Financial Model (PCFM) and Price Control Financial Handbook (Handbook), collectively known as the Price Control Financial Instruments (PCFI) and to make minor corrections.

On 27 February 2024 we published our consultation on the proposed RIGs and RRP for RIIO-ET2 under Standard Condition B15 and PCFM Guidance under Special Condition 8.2 of the Electricity Transmission Licence. This consultation set out our proposed reporting templates and accompanying guidance. We highlighted that these templates were an evolution of the data submission that accompanied the RIIO-ET2 Business Plan, which we used as the basis for setting allowances and outputs for the RIIO-ET2 price control period. We sought feedback on the form and content of the RIGs, RRP and PCFM Guidance and more generally how we intend to monitor performance during the RIIO-ET2 period.

We received three responses to the consultation which raised a number of points relating to the reporting requirements. Our views in relation to these responses and any changes are set out in Appendix 1 to this Decision.

General updates

In addition to changes arising from consultation responses, we have included a number of changes and corrections to the RRP pack as well as updates to the RIGs and PCFM guidance to clarify reporting requirements.

The reason for these changes is to align the terminology and calculations within the RIGs and RRP with the RIIO-2 licence and PCFI so that we are able to gather the relevant data required to administer and monitor the RIIO-2 price controls.

Timeline

The modifications to the RIGs will take effect on 02 May 2024. For the avoidance of doubt, this means that the data submitted in July 2024 (in respect of the 2023/24 reporting year) will use the RRP and RIGs, as modified.

Yours faithfully,

Nathan Macwhinnie

Deputy Director

Price Control Operations

Duly authorised on behalf of the Authority

Appendix 1: Consultation responses and Ofgem views

We received three responses to our consultation on proposed modifications to the RIGs, RRP and PCFM Guidance which raised a number of points relating to the reporting requirements. The respondents also highlighted a number of technical issues contained within the template and guidance. These included:

- corrections of formulaic errors;
- updates to data categorisation;
- references;
- clarifications; and
- proposed changes and additions to data input within the RRP.

We have addressed these detailed technical and functional matters and they are reflected in the final published versions of the documents.

One respondent welcomed the proposed changes to, and clarification of, guidance in relation to Closely Associated Indirect (CAI) activities. They supported, in principle, a focus on Network Design and Engineering (NDE) and Project Management (PM) activities as a subset of CAI to further develop reporting so that these activities can be separately identified as External (e.g. contractors) and Internal (e.g. ETOs) for recording in relevant tables.

A second respondent commented that the definitional clarifications for CAI costs and the associated appendices will help TOs in complying with the intent of the changes first introduced in the 2023 RIGs consultation. However, they noted their concern that changes to reporting definitions made during the RIIO-T2 price control, may reduce comparability to previous RRP submissions, data previously submitted as part of prior price controls and reduces the effectiveness of mechanisms that were calibrated at the start of the price control (e.g. the Opex Escalator).

Our View: We recognise that any developments and definitional improvements have the potential to impact comparability with prior reporting years and the interaction with price control mechanisms. However, we believe the benefits help to improve cost reflectivity across the activity definitions which is a key cornerstone of our ability to properly interrogate and benchmark costs across the ET sector.

The third respondent welcomed the work that Ofgem has undertaken to clarify its desired treatment of Direct and Indirect costs for the purpose of RRP24. However, they noted a

number of issues and/or points of clarification as listed below.

- Draft RIGs do not fully reflect the most recent discussions with the Scottish TOs.

Our View: We believe we have adequately reflected the RIGs discussions with all TO's and our desired intent within the RIGs. We have reviewed the consultation responses and provided further clarity where required but this has not significantly altered our definitions and their intended application.

- Rationalisation required to remove contradictory elements.

Our View: We have undertaken a further review of the RIGs and sought to remove any contradictory elements from the RIGs. We believe the decision version published alongside this letter achieves our aims.

- RIGs consultation does not reflect Ofgem's latest intent. Specifically for the two categories that are mapped to "very" Closely Associated Indirect ("CAI") Activities, the treatment of the costs associated with those activities will vary depending on who is undertaking the activity and when it is being undertaken.

Our View: We believe that the RIGs consultation accurately sets out our intent regarding the "very" CAI and the situations to which these definitions are applicable. We have provided further clarification in the RIGs version published alongside this letter. For clarification, the inference made in the respondent consultation response that all "very" CAI become direct costs upon the commencement of construction is incorrect. Only contractor project management costs (as defined under project management definitions table in appendix 3) for the applicable asset/output may be treated as direct upon construction commencing. Where other assets/outputs are pre-construction, the contractor project management costs pertaining to these deliverables will be treated as indirect). Design costs direct/indirect treatment is determined by the nature of the design task being undertaken as defined under the memo tables in Appendix 3 of the RIGs (e.g. detailed design down to the level where assets are physically connected; design works which are included in the construction of assets or asset specific manufacturing configuration design). This position was set out in our consultation letter dated 27 February 2024.

- The respondent's stated understanding from bilateral conversations with Ofgem; the RIGs intention is that FY22 and FY23 costs should be reported according to the 'old RIGs' (v1.7 as published in 2023) but costs in respect of FY24 onwards should be

reported according to the 'new RIGs' (as will be directed by Ofgem following the conclusion of this consultation). However, this intention is not evident from the drafting and the proposed RRP24 RIGs make no reference to prior RIGs which should be followed in respect of FY22 and FY23.

Our View: ETOs must adhere to and be compliant with the RIGs requirements regarding the recording of all indirect costs. For the current ET2 RIGs, applicable for 23/24 reporting and beyond (i.e. forecast), this necessitates the delineation of direct and indirects as per the definitions for each activity. Cost and activity for the reporting years 21/22 & 22/23 may be provided on the basis used for the previous RRP submissions. These prior years can be replicated from the historical RRP and are not required to be restated using the definitional clarification provided as part of the 23/24 RIGs decision.

- Having a change in definition between FY22-FY23 and the remainder of the RIIO-T2 period also raises a wider concern because it is an emerging requirement that data for the RIIO-T2 years must be the same as data in the T3 BPDT.

Our View: Any T3 BPDT data submission requirements including the definitions to be applied will be directed by Ofgem through the T3 consultation process and is not a consideration for the publication of these RIGs.

- Due to the ongoing lack of an agreed definition, we have not been able to start to collect costs associated with contractor 'Indirect' activities that are to be mapped to CAI. Consequently, we are unable to comply with the proposed new requirement for data. We will either seek a formal derogation under Part D of Condition B15 or will be relying on an estimation and allocation process to populate Indirect costs that are to be mapped to CAI for RRP24. We request clarification of Ofgem's expectations regarding a pragmatic and proportionate 'allocation process' that can be adopted here.

Our View: We have decided not to provide a formal derogation under Part D of Condition B15 as this would significantly undermine our ability provide meaningful oversight of TO's ability to fulfil their regulatory settlement. With all forms of regulatory reporting, we require TO's to provide their cost and volume information using reasonable endeavours. As previously communicated, we require an appropriate and commensurate level of intelligence to be collected by the TO's to inform what activities have been undertaken and what the cost of that activity has or will be. All TO's demonstrated their competence in this regard in the 1st two years of reporting in T2 with all parties assuring us of the veracity of the cost data presented and that this was subject to rigorous assurance and

directorate sign-off. We also note that each of the TO's has evidenced and demonstrated in their internal work allocation cost models their ability to take costs for activities to a far more granular level of detail than that required in the RRP and have used this granular oversight as a justification and evidence in support of their funding submissions in both business plans and reopener applications. Our intention to improve cost reflectivity across the activity definitions is a key cornerstone of our ability to properly interrogate and benchmark costs across the ET sector and intends to be agnostic to the particular contracting strategies or accounting policies employed by the different TO's. The definitions for indirects have been previously consulted on for their use in both the T2 business plan submission and the 1st two year of RIIO-T2 reporting and are well established.

- The provision of data from an 'internal Contractor Management System' assumes that the project in question is in its delivery phase, i.e. a contractor is engaged and reporting actual costs for the Reporting Year. There will be a significant proportion of projects in each Reporting Year that are in a pre-delivery phase, therefore contractor costs will be forecast and not split out in the required way in an 'internal Contractor Management System'. In bilateral discussions with Ofgem, it was agreed that a proportionate allocation process (as has been used previously to pro-rate and phase Direct capex costs at an asset level, and a flat percentage to date to split out ETO Indirect costs) would be acceptable for projects that are not yet in delivery. We request the updated RIGs clearly reflect this agreement.

Our View: Ofgem accepts and recognises the need to use allocation and attribution methodologies to assign costs to the relevant cost categories. This applies to both actual expenditure, given the differing contract and billing arrangements agreed with third party delivery partners, or forecast information predicated on initial design estimates or contractual frameworks for example. In all cases we require an appropriate and commensurate level of intelligence to be collected by the TO's to inform what activities have been or will be undertaken and what the cost of that activity has or will be. We anticipate that any assumptions used in these attribution and allocation methodologies to be regularly reviewed to ensure they remain fit for purpose and accurately reflect the effort expended and subsequent cost attribution. It is for each TO to demonstrate and evidence to Ofgem that the methodology employed is suitably justified and is subject to rigorous governance and oversight for each reporting cycle.

- Multiple years of incremental changes have made the changes to the definitions for Direct & Indirect Activities in the RIGs hard to follow and unclear in intent and meaning.

Our View: We believe that the RIGs are clear in both their intent and meaning. This clarity is achieved both within the document itself as well as the numerous discussions we have undertaken with TO's to discuss our position and listen to and act on revisions proposed by the TO's. We welcome any engagement and proposals to improve the clarity of the RIGs and many of such proposals have been incorporated into various iterations to date. We consider the RIGs to be constantly evolving and improving to better reflect the regulatory reporting needs of Ofgem while acknowledging the particular reporting practices and/or limitations of data collection of the TO's systems and processes.

- The term 'Contractor' needs to be defined in a way that reflects the fact that we believe the RIGs should apply equally to all investment projects regardless of delivery model.

Our View: We believe that the term contractor is a commonly used and well understood term. An attempt to comprehensively define this term may inadvertently create unintended consequences and limit our intention.

- It is essential that we have a cross-ETO discussion with Ofgem on these updated definitions for Indirect activities to ensure that ETOs all have the same understanding of Ofgem's intent and that this intent is implemented into the RIGs in a clear and understandable way.

Our View: As stated above, we believe that the RIGs adequately set out our reporting requirements and that the definitional points are clear and well understood. However, we will continue to work with the TO's throughout the reporting cycle to refine and improve the RIG's where appropriate to do so.

One respondent highlighted that the SO:TO incentive has been extended for the remainder of RIIO-ET2, which has been reflected in the changes made to the applicable tables. As part of this licence change, the incentive calculation was adjusted however the tables do not reflect this. The consultation issues log has been updated with proposals as to how this can be rectified.

Our View: We have revised the applicable table to ensure the correctness of the SO:TO incentive rates.

One respondent noted Final Determinations state Instrument Transformer, Bay Assets, Protection and Control and Overhead Line Conductor PCD allowances should remain as

per Final Determinations. These allowances are then reviewed at the end of the price control and subsequently adjusted. The PCFM Input Summary tab does not return the same value as Final Determinations and have proposed a solution.

Our View: We have updated the RRP template to ensure that the Instrument Transformer, Bay Assets, Protection and Control and Overhead Line Conductor PCD licence values are feeding through into the PCFM Input Summary tab. Following the price control, the formula and tables for each respective PCD under the "PCDs – Supporting Calculations" will need to be updated to ensure the correct adjustments are made.

One respondent noted the PCFM Guidance states for Adjusted Net Debt and Tax Deductible Net Interest Cost to use the RFPR values reported as "Net Debt as per the Regulatory (RIIO-2) Definition" and "Net Interest as per the Regulatory (RIIO-2) definition". These values from RFPR do not include the forecasts for new financing/refinancing net interest costs and new debt/refinancing. The PCFM guidance should be updated to include these forecasts in the PCFM input variable values and therefore use the rows "Net Interest including forecast new financing/refinancing costs" and "Regulatory Net Debt including forecast new debt/refinancing" respectively.

Our View: we agree with the suggested change to the PCFM Guidance and have updated the guidance for Adjusted Net Debt and Tax Deductible Net Interest cost accordingly

One respondent highlighted that the 2024 regulatory reporting year brings with it heightened pressure due to the overlap between the annual RIIO-T2 RRP and RIIO-T3 Business Plan Data Template (BPDT) submission dates making the process of planning internal resources challenging. They request that no further significant changes to the RIGs for 2024 are made beyond those already proposed and under development, including templates.

Our View: we acknowledge the challenges for TO's in managing the requirements of both T2 annual reporting and planning for T3. We will endeavour to minimise any revisions to the RIGs and RRP templates as much as possible. However, we retain the option to make future changes where these are deemed necessary and in our opinion the value outweighs any additional burden placed on either Ofgem or the TO's.

**National Grid Transmission plc
SP Transmission Limited
Scottish Hydro Electric Transmission plc**

(each one a “Licensee”, and together, “the Licensees”)

Direction under paragraph 3 of Standard Condition B15 (Regulatory Instructions and Guidance) (“SC B15”) and paragraph 8.2.20 of Special Condition 8.2 (Annual Iteration Process for the ET2 Price Control Financial Model) of the Electricity Transmission Licence (the “Licence”) granted to the Licensees under section 6(1)(b) of the Electricity Act 1986 (the “Act”).

Whereas –

1. The Licensees each hold an Electricity Transmission Licence (the “Licence”) granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 (the “Act”) and are subject to the conditions contained in the Licence.
2. The RIIO-ET2 Electricity Transmission Price Control - Regulatory Instructions and Guidance (the “RIGs”) and the Regulatory Reporting Pack (the “RRP”) are the primary means by which the Gas and Electricity Markets Authority (“the Authority”)² directs the Licensees to provide information required by the Authority to administer the conditions of the Licence and, where not referenced in the Licence, the RIIO-ET2 Final Determinations.³
3. In accordance with paragraph 8 of SC B15 and paragraph 23 of SpC 8.2 of the Licence, the Authority gave notice to the Licensees on 27 February 2024⁴ that it proposed to modify the RIGs, RRP and PCFM Guidance for RIIO-ET2.
4. The notice required any representations by licensees on the proposals to be made on, or before, 26 March 2024.
5. Prior to the consultation period closing the Authority received three responses. The Authority has considered the representations and has made a number of changes to the RIGs, RRP and the PCFM Guidance proposed as part of the consultation.

² 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.

³ <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

⁴ [Regulatory Reporting Pack and Regulatory Instructions and Guidance - proposed modifications | Ofgem](#)

6. The modifications refer specifically to information required to be submitted to the Authority on or before 31 July 2024 in relation to:
 - RIIO-ET2 – Regulatory Instructions and Guidance: Version 1.8;
 - RIIO-ET2 PCFM Guidance: Version 1.3; and
 - RIIO-GD2 Regulatory Reporting template: Version 2.5.
7. The modifications are summarised in the attached Decision letter and can be seen in the versions of the RIGs and PCFM Guidance documents specified above and published alongside this Direction.

Now Therefore –

8. Pursuant to paragraph 3 of SC B15 of the Licence, the Authority hereby modifies the RIGs; and pursuant to paragraph 20 of SpC 8.2, the Authority hereby modifies the PCFM Guidance in the manner specified in the attached Schedule.
9. The reason for the amendments set out in this Direction is to introduce with immediate effect the new reporting requirements set out in the RIGs which will allow the Authority to track and monitor company performance against their RIIO-2 price control settlement and to ensure consistency with the principles. This decision also aligns the template and guidance with the latest special licence conditions and Price Control Financial Instruments.
10. This document constitutes notice of the Authority's reasons for the Direction as required by section 49A of the Act.
11. The modifications will take effect on 02 May 2024.
12. The Licensees must complete and return the reporting pack referred to above as part of the 2023/24 RIGs process.

Nathan Macwhinnie
Deputy Director
Price Control Operations

Duly authorised on behalf of the Authority
02 May 2024