



Consultation

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Response deadline:	28 February 2014	Team:	RIIO-ED1
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Overview

We are consulting on our proposed changes to the Charge Restriction Conditions (CRCs) required to implement the RIIO-ED1 price control settlement for the four licensees of Western Power Distribution (WPD). These conditions will apply from 1 April 2015.

On 22 November 2013, we proposed to fast-track (settle the price control early) the four licensees of Western Power Distribution (WPD). This document consults on a subset of the licence changes that will enable us to implement WPD's settlement, should we decide to fast-track it.

On 10 January 2014 we published 'RIIO-ED1: Informal consultation on fast-track licence drafting – Charge Restriction Conditions (Part 1)'. This is consulting on most of the draft CRCs proposed to implement RIIO-ED1 for WPD.

Part 2 (this consultation) follows on from, and should be read in conjunction with, the part 1 consultation. It comprises of two elements: the draft CRCs that were not included in the part 1 consultation, and Section 1 of the ED1 Price Control Handbook.

Context

RIIO-ED1 is the first electricity distribution price control to reflect the new RIIO (Revenue = Incentives + Innovation + Outputs) model. In the RIIO-ED1 price control review we will set the outputs that the 14 electricity distribution network operators (DNOs) need to deliver for their consumers and the associated revenues they are allowed to collect. The RIIO-ED1 review covers the eight-year price control period which lasts from 1 April 2015 to 31 March 2023.

In March 2013 we published our Strategy decision on the key elements of the regulatory framework that the DNOs would need to understand to develop their business plans.

On 22 November we concluded our assessment of the DNOs' business plans. We published our assessment and proposed that Western Power Distribution's (WPD) plans for its four DNOs are of sufficiently high quality that its price control could be settled early. To finalise the settlement we need to change WPD's licence conditions. These changes come in two parts: the Standard Licence Conditions (SLCs), which apply to all DNOs, and Charge Restriction Conditions (CRCs), which are individually applicable to each DNO.

If we conclude that fast-tracking WPD is appropriate then we will aim to make the necessary modifications to WPD's CRCs. At the same time, where possible, we will look to make changes to the SLCs that can be modified early for all electricity distributors. We will seek to implement these licence changes between May and June, with most conditions becoming active on 1 April 2015.

Associated documents to this consultation

Documents published alongside this consultation

- Supplementary annex 1: Draft RIIO-ED1 fast-track CRC licence changes (Part 2)
- Supplementary annex 2: Response template
- Supplementary annex 3: ED1 Price Control Financial Handbook (Section 1)

Other relevant documents

- <u>RIIO-ED1: Informal consultation on fast-track licence drafting Charge</u> <u>Restriction Conditions (Part 1)</u>
- <u>RIIO-ED1: Informal consultation on licence drafting-Standard Licence Conditions</u>
- Assessment of RIIO-ED1 business plans and fast-tracking
- <u>RIIO-ED1 Draft Determinations for Western Power Distribution Ltd</u>
- <u>Strategy decision for RIIO-ED1 Overview</u>
- <u>RIIO ED1 Glossary</u>

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Executive summary

On 22 November 2013 we published our assessment of the business plans submitted by the DNOs.¹ We concluded that Western Power Distribution's (WPD) business plans, for its four licensees, are the only plans that are high quality across the board and offer value for money for consumers. We are therefore consulting on concluding WPD's price control settlement early ('fast-tracking'). At the same time we also published the Draft Determinations for WPD, setting out the details of its proposed settlement.² Both of these consultations have recently closed and we are now considering stakeholders' comments. If we decide to fast-track WPD, its licences will be issued earlier than the other DNOs (slow-tracked companies).

The price control settlement is implemented through the licence for the DNOs. The licence comprises of Standard Licence Conditions (SLCs), which are applicable to all DNOs, and Charge Restriction Conditions (CRCs) which are unique to each DNO.

On 10 January 2014 we published 'RIIO-ED1: Informal consultation on fast-track licence drafting – Charge Restriction Conditions (Part 1)' ('CRC Informal consultation part 1') which is consulting on the majority of the draft CRCs proposed to implement RIIO-ED1 for WPD.³

This consultation ('CRC Informal consultation part 2') follows on from, and should be read in conjunction with, the CRC Informal consultation part 1. It contains draft CRCs that were not included in CRC Informal consultation part 1. It also includes a draft of Section 1 of the ED1 Price Control Handbook. This sets out the methodologies that will be followed during RIIO-ED1 to update licensees' revenue allowances for RIIO-ED1 policy-related schemes.

Since CRC Informal consultation part 1, we have decided to alter the licence development timetable to allow more time to develop the methodologies to close out electricity distribution price control review 5 (DPCR5) schemes during RIIO-ED1. We will now conduct a separate consultation on our approach to close out the DPCR5 schemes ('DPCR5 legacy consultation').

Further work is required to finalise the conditions and ensure they reflect the Final Determinations for WPD (should we decide to fast-track it) which we expect to publish in February 2014. We intend to conduct the requisite 28 day statutory consultations on the changes to WPD's CRCs in March and publish the licence modification decisions in May. Most CRCs for WPD will become active on 1 April 2015.

The formal consultation related to the DPCR5 legacy consultation is expected to take place in April 2014. The decision is scheduled for late May/ early June 2014.

¹ <u>RIIO-ED1 Business plan assessment and fast-tracked consultation</u>

² RIIO-ED1 Draft Determinations for Western Power Distribution Ltd

³ RIIO-ED1: Informal consultation on fast-track licence drafting – Charge Restriction Conditions (Part 1)

1. Introduction

Chapter Summary

A guide to the purpose and structure of the document.

Purpose of this document

1.1. In this document we set out our current thinking and request your views on:

- the updated timetable for RIIO-ED1 licence development
- the proposed changes to the Charge Restriction Conditions (CRCs) for WPD's four licensees which relate to the conditions that were not covered in CRC Informal consultation part 1
- Section 1 of the ED1 Price Control Financial Handbook for WPD. This sets out the methodologies that will be followed to update licensee's revenue allowances for RIIO-ED1 policy related schemes.

1.2. Our proposed licence drafting reflects the policy position detailed in the Strategy decision and within the Draft Determinations published for Western Power Distribution (WPD).⁴ Should we decide to fast-track WPD, we expect to publish its Final Determinations in February.

Approach to licence drafting for RIIO-ED1

1.3. Further information on our approach to licence drafting for RIIO-ED1 can be found in Chapter 1 of CRC Informal consultation part 1.

1.4. As part of RIIO-ED1, we have proposed a new structure for the CRCs. This is explained in Chapter 2 of CRC Informal consultation part 1. The new structure is also set out in Appendix 2 of this consultation.

Responding to this consultation

1.5. We would like to hear your views on the proposed changes to WPD's CRCs set out in Supplementary annex 1: Draft RIIO-ED1 Fast-track CRC licence changes (Part 2). We would also welcome your comments on the proposed drafting for Section 1 of the ED1 Price Control Financial Handbook (Supplementary annex 3) and the specific questions posed in this consultation.

1.6. If you would like to submit your views on Supplementary annexes 1 and 3, please use the Response Template (Supplementary annex 2) to provide any substantive feedback on each licence condition. Ensure that any points raised in the

⁴ <u>Strategy decision for the RIIO-ED1 electricity distribution price control</u> and the <u>RIIO-ED1 Draft</u> <u>Determinations for fast-tracked Distribution Network Operators – Western Power Distribution</u>

cover letter are also made in the Response Template. You can supply any minor points on the individual licence drafts (eg formatting and drafting improvements) in a tracked-change version of the relevant licence condition.

Structure of this document

- 1.7. The remainder of this document is structured as follows:
- Chapter 2 details the licence development timetable and the proposed changes to the individual CRCs
- Chapter 3 outlines the purpose of the ED1 Price Control Financial Handbook.
- 1.8. Alongside this document we have also published the following:
- Supplementary annex 1: Draft RIIO-ED1 fast-track CRC licence changes (Part 2)
- Supplementary annex 2: Response template
- Supplementary annex 3: ED1 Price Control Financial Handbook (Section 1).

1.9. Figure 1 below maps out the documents being published today and how they relate to the documents we published on 10 January and future publications.





2. Licence development timetable and proposed changes to the CRCs

Chapter Summary

Sets out our timetable for RIIO-ED1 licence development and our proposed changes to the CRCs for WPD.

Question 1: Do you have any views on the proposed changes to the CRCs? The draft licence conditions are found in Supplementary annex 1. **Question 2:** Do you have any views on the updated reasons and effects for the licence changes proposed in this consultation?

Timetable for licence development

2.1. Since the publication of CRC Informal consultation part 1, we have decided to alter the licence development timetable. We have done this to allow more time to develop the methodologies to close out electricity distribution price control 5 (DPCR5) schemes during RIIO-ED1.

2.2. The methodologies to close out DPCR5 schemes will be found in Section 2 of the ED1 Price Control Financial Handbook ('the handbook'). Further information on the handbook can be found in Chapter 3.

2.3. The handbook is part of the licence. This is because of its importance to the determination of licensees' allowed revenue. This means that to introduce the handbook we need to follow the same procedure as when changing the licence (ie statutory consultation and licence modification decision).

2.4. The timetable changes below mean the process to implement Section 2 of the handbook for WPD will now run on a later timetable than the other licence changes we are proposing.

2.5. We now intend to conduct a separate consultation on our approach to close out DPCR5 schemes ('DPCR5 legacy consultation'). The DPCR5 legacy consultation will be published on 28 February. It will contain the following:

- Section 2 of the ED1 Price Control Financial Handbook for WPD
- policy related changes that are required to close out DPCR5 schemes during RIIO-ED1 – this applies to all Electricity Distribution Network Operators (DNOs).

2.6. The updated timetable for the RIIO-ED1 licence changes for SLCs and CRCs is in Table 1 and the key points are:

- the introduction of the DPCR5 legacy consultation means we will now conduct the formal consultation on Section 2 of WPD's handbook on a separate timetable from the other licence changes – approximately one month later
- the timetable is unchanged, from what was set out in CRC Informal consultation part 1, for the development of the:
 - CRCs for WPD's four licensees (including Section 1 of WPD's handbook)
 - SLC modifications that can be finalised early for all Electricity Distributors
 - slow-track companies' CRCs
 - \circ $\;$ SLCs that we are unable to finalise early.

Table 1: Timetable for RIIO-ED1 licence development

Stage	Date		
Charge Restriction Conditions			
WPD			
CRC Informal consultation part 2	31 January 2014		
Response deadline for CRC Informal consultation part 1	7 February		
Response deadline for CRC Informal consultation part 2	28 February		
DPCR5 legacy consultation	28 February		
Response deadline for DPCR5 legacy consultation	28 March		
28 day statutory licence modification consultations and notices published (including Section 1 of the ED1 Price Control Financial Handbook)	March 2014		
28 day formal consultation published for Section 2 of the ED1 Price Control Financial Handbook	April 2014		
Licence modification decisions and modifications published	May 2014		
Modifications published for Section 2 of the ED1 Price Control Financial Handbook	May/June 2014		
Licence changes come into force*	1 April 2015		
Slow-track companies			
Informal licence drafting consultation	September 2014		
28 day statutory licence modification consultations and notices published	December 2014/		
	January 2015		
Licence modification decisions and modifications published	February 2015		
Licence changes come into force	1 April 2015		
Standard Licence Conditions			
All Electricity Distributors: RIIO-ED1 SLC modifications that can be finalise			
Response deadline for SLC Informal consultation	7 February		
28 day statutory licence modification consultation and notices published	March 2014		
Licence modification decision and modifications published	May 2014		
Licence changes come into force	1 April 2015		
All Electricity Distributors: RIIO-ED1 remaining SLC modifications			
Informal licence drafting consultation	September 2014		
28 day statutory licence modification consultation and notices published	December 2014/ January 2015		
Licence modification decision and modifications published	February 2015		
Licence changes come into force	1 April 2015		
*Except for condition CRC 4C (Price Control update provisions for Fast-Track licensees), which will come into force for WPD licensees in Summer 2014 and is in effect until 1 April 2015.			

Draft RIIO-ED1 licence conditions

2.7. Our proposed CRC licence changes are in Supplementary annex 1: Draft RIIO-ED1 Fast-track CRC licence changes (Part 2). These are the remaining licence conditions that were not included in CRC Informal consultation part 1, namely:

- CRC 2M. Adjustment of licensee's revenues for the residual distribution losses incentive
- CRC 3A. Legacy price control adjustments
- CRC 3K. Rail electrification adjustments
- CRC 5F. Services for managing Theft of Electricity from the Distribution System
- 2.8. The proposed licence changes set out in Supplementary annex 1 are either:
- an amendment to a current CRC (ie a condition already active in the DPCR5 licence) or
- a new CRC for RIIO-ED1.⁵

2.9. In Chapter 3 of CRC Informal licence consultation part 1, we are consulting on the reasons and effects for all the proposed licence changes. The reasons and effects for the conditions included in consultation have been updated from those that were included in CRC Informal licence consultation part 1 – this is to reflect the changes to the draft conditions.

Reasons and effects for proposed CRC changes

2.10. The reasons and effects for the proposed CRCs in the order they appear in our proposed new structure of the licence for RIIO-ED1 (see Appendix 2).

CRC 2M. Adjustment of licensee's revenues for the residual distribution losses incentive

<u>Type of change:</u> Amendment <u>Current number:</u> CRC 7 <u>Current name:</u> Adjustment of licensee's revenues to reflect distribution losses performance

2.11. We are proposing to modify this condition for the following reasons. The residual losses incentive from the DPCR4 price control period (the PPL term) was originally due to be recovered during DPCR5 through licence condition CRC 7. Owing to volatility of data used to measure losses in 2009-10, we are still in the process of closing out the losses mechanism for DPCR4 and have yet to direct the PPL term. On 25 April 2013, we issued a letter stating that the earliest year for which we will be directing recovery of the PPL term is likely to be 2015-16, the first year of RIIO-ED1.

⁵ Further description of the types of licence adjustments can be found in Chapter 3 of CRC Informal consultation part 1.

That letter also made clear that we will direct the period for recovery taking account of the date on which the direction is made. 6

2.12. Therefore we propose to include a licence condition in the RIIO-ED1 licence to update the current CRC 7 condition. This will allow recovery of the PPL term during RIIO-ED1, giving effect to the policy intent that we have already communicated on this issue.

CRC 3A. Legacy price control adjustments

Type of change: New condition

2.13. This proposed condition provides for price control financial adjustments that will arise with respect to:

- activities carried out by the licensee
- expenditure incurred by the licensee, and/or
- allowed expenditure levels for the licensee.

2.14. The reason for this condition is to make provision for the finalisation of values for the calculation of the licensee's Opening Base Revenue Allowances for the Regulatory Years prior to 2015/2016 (the "legacy period") which could not be finalised before, either because complete data was not available in time, or because reviews, proposals or determinations were outstanding.

2.15. The effects of the condition are as follows:

- to divide legacy price control adjustments into three categories, listed below:
 - adjustments to opening tax pool balances LTPG, LTPS, LTPD and LTPC values
 - $\circ~$ adjustments subject to the DPCR5 RAV Rolling Incentive mechanism RIRAV and RIREV values
 - other legacy price control adjustments OLRAV and OLREV values.
- to allow revisions to the PCFM Variable Values set out above to affect the calculation of the value for MODt for the licensee under the Annual Iteration Process.

⁶ <u>https://www.ofgem.gov.uk/publications-and-updates/timing-recovery-close-out-values-losses-incentive-mechanism-fourth-distribution-price-control-review-dpcr4</u>

CRC 3K. Rail electrification adjustments

Type of change: New condition – WPD licensees only

2.16. The reason for introducing this new condition is to allow the Authority, by way of direction, to amend WPD's settlement in the situation where a third party is funding the costs associated with rail electrification that WPD has been funded for. We stated in WPD's Draft Determination that we would introduce this condition in order to remove ex ante funding provided to WPD for diversions associated with Network Rail's electrification programme, should these costs be funded by another party.

2.17. The effect of introducing this condition is to enable a reduction to be made to MOD by direction of the Authority through operation of a PCFM variable value under the circumstances referred to above.

CRC 5F. Services for managing Theft of Electricity from the Distribution System

Type of change: New condition

2.18. The reason is to ensure that consumers share some benefit in income arising from actions taken by licensees in respect of Relevant Theft of Electricity.

2.19. The effect of this condition is to apply the Efficiency Incentive Rate sharing factor to such income by applying an amount equal to it as a negative adjustment to totex allowed revenue.

3. ED1 Price Control Financial Handbook

Chapter Summary

An outline of the purpose and content of the ED1 Price Control Financial Handbook governed by the CRC 4A.

Question 1: Do you have any comments on the draft of Section 1 of the ED1 Price Control Financial Handbook included in Supplementary annex 3?

3.1. The draft licence condition CRC 4A (Governance of ED1 Price Control Financial Instruments), included in CRC Informal consultation part 1, establishes the ED1 Price Control Financial Handbook ('the handbook') and its associated governance arrangements.

3.2. The purpose of the handbook is to provide licensees, and other interested parties, with the process steps and methodologies that will be followed during RIIO-ED1. These will cover annual remodelling of licensees' base revenue allowances through the 'Annual Iteration Process' of the Price Control Financial Model.

- 3.3. The handbook is split into two sections:
- Section 1: the methodologies that will be followed during RIIO-ED1 to update revenue allowances for RIIO-ED1 policy-related schemes. These are the schemes found in CRC 3B to CRC 3K of the proposed new licence for WPD. The latest draft of Section 1 can be found in Supplementary annex 3: ED1 Price Control Financial Handbook (Section 1)
- Section 2: the methodologies that will be followed during RIIO-ED1 to update revenue allowance to close out DPCR5 schemes. These DPCR5 schemes will be set out the proposed new licence condition CRC 3A (Legacy price control adjustments) included in Supplementary annex 1. Section 2 will be consulted on as part of the DPCR5 legacy consultation on the 28 February

3.4. Before the DPCR5 legacy consultation, we plan to use the licence drafting working group to discuss and develop, the process steps and methodologies required to close out DPCR5 schemes (ie Section 2 of the handbook).

3.5. The ED1 Price Control Financial Handbook is part of the licence and is specific to each licensee. Therefore, it needs to be implemented through licence statutory consultation and modification notice. The timetable for implementing Sections 1 and 2 of the handbook for WPD is set out in Chapter 1 of this consultation.

Appendices

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Appendix 1 - Consultation response and questions

1.1. We would like to hear your views on any of the issues set out in this document.

1.2. We especially welcome responses to the specific questions at the beginning of each chapter. These are replicated below.

1.3. Responses should be received by 28 February 2014 and should be sent to <u>thomas.mackenzie@ofgem.gov.uk</u>

1.4. Unless marked confidential, all responses will be published in our library and on our website <u>www.ofgem.gov.uk</u>. You may request that your response is kept confidential. We shall respect this request, unless the law requires us to disclose anything, for example - under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. Respondents are asked to put any confidential material in the appendices to their response.

1.6. We intend to publish our decision on the draft licence conditions following the timetable set out in Chapter 2, after considering the responses to CRC Informal consultation 1 and this consultation. Any questions should, initially be directed to:

- Tom Mackenzie
- 0207 901 7406
- <u>thomas.mackenzie@ofgem.gov.uk</u>

Chapter: Two

- **Question 1:** Do you have any views on the proposed changes to the CRCs? The draft licence conditions are found in Supplementary annex 1.
- **Question 2:** Do you have any views on the updated reasons and effects for the licence changes proposed in this consultation?

Chapter: Three

• **Question 1:** Do you have any comments on the draft of Section 1 of the ED1 Price Control Financial Handbook included in Supplementary annex 3?

Appendix 2 - Outline of the CRCs structure for RIIO-ED1 Licence

RIIO-ED1 Condition number and name		Current DPCR5 licence condition	Associated document?	Draft Condition in Supplementary Annex 1? ⁷
Chap	ter 1: Interpretation of Part 4			
1A	Overview of Part 4	CRC 1	No	No
1B	Interpretation of Part 4	CRC 2	No	No
Chap	ter 2: Electricity Distribution Revenue Restriction			
2A	Restrictions of Allowed Distribution Network Revenue	CRC 3, 5 and 14	No	No
2B	Calculation of Allowed Pass-through Items	CRC 4	No	No
2C	Broad measure of customer service	CRC 8	Yes	No
2D	Adjustment of licensee's revenues to reflect interruptions related quality of service performance	CRC 8	No	No
2E	Incentive on Connections Engagement	New	Yes	No
2F	Time to Connect Incentive	New	No	No
2G	The Losses Discretionary Reward	New	Yes	No
2H	The Network Innovation Allowance	New	Yes	No
2I	Not Used	New	No	No
2J	Low Carbon Networks Fund	CRC 13	Yes	No
2K	Margins on Licensee's Connection Activities	CRC 12	No	No
2L	Revenue adjustments in respect of performance failures	CRC 12	No	No
2M	Adjustment of licensee's revenues for the residual distribution losses incentive	CRC 7	No	Yes
Chap	ter 3: Annual Iteration Process - Adjustments to the Revenue Restriction			
3A	Legacy price control adjustments	New	No	Yes
3B	Determination of PCFM Variable Values relating to actual Totex expenditure for Totex Incentive Mechanism Adjustments	New	No	No
3C	Specified financial adjustments	New	No	No
3D	The Innovation Roll-out Mechanism	New	No	No
3E	Smart Meter Roll-out Costs	New	No	No

⁷ If 'No' in this column, then the draft licence condition can be found in CRC Informal consultation part 1.

RIIO-ED1 Condition number and name		Current DPCR5 licence condition	Associated document?	Draft Condition in Supplementary Annex 1? ⁷
3F	Arrangements for the recovery of uncertain costs	CRC 18	No	No
3G	Revising the allowed level of Load Related Expenditure	CRC 18	No	No
3H	Allowed expenditure on improving services to Worst Served Customers	New	No	No
3I	Not Used	New	No	No
3J	Allowed Expenditure on Visual Amenity Projects	New	No	No
3K	Rail electrification adjustments	New (WPD only)	No	Yes
Chap	ter 4: Price Control Financial Instruments			
4A	Governance of ED1 Price Control Financial Instruments	New	No	No
4B	Annual Iteration Process for the ED1 Price Control Financial Model	New	No	No
4C	Price Control update provisions for Fast-Track licensees	New (WPD only)	No	No
Chapter 5: Other Revenue Restriction Related Conditions				
5A	The Networks Innovation Competition	New	Yes	No
5B	Restriction of charges for the provision of Legacy Metering Equipment	CRC 6	No	No
5C	Directly Remunerated Services	CRC 15	No	No
5D	Assessment of Network Asset Secondary Deliverables	New	No	No
5E	Charging outside the Distribution Services Area	CRC 16	No	No
5F	Services for managing Theft of Electricity from the Distribution System	New	No	Yes
5G	Net to gross adjustment for load related expenditure	New	No	No
5H	Not used	New	No	No
5I	Not used	New	No	No
5J	No used	New	No	No
5K	Disapplication	CRC 19	No	No
Propo	osed Removal from Current Licence			
9	Adjustment of licensee's revenues to reflect performance in relation to Transmission Connection Point Charges	Removal	No	NA
10	Adjustment of licensee's revenues to reflect innovation funding performance	Removal	No	NA
11	Adjustment of licensee's revenues to reflect performance in relation to Distribution Generation	Removal	No	NA
17	Assistance for high-cost distribution areas	Removal	No	NA

Appendix 3 – feedback questionnaire

1.1. Consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. We would be keen to get your answers to the following questions:

- **1.** Do you have any comments about the overall process, which was adopted for this consultation?
- **2.** Do you have any comments about the overall tone and content of the report?
- 3. Was the report easy to read and understand, could it have been better written?
- 4. To what extent did the report's conclusions provide a balanced view?
- **5.** To what extent did the report make reasoned recommendations for improvement?
- 6. Please add any further comments?

1.2. Please send your comments to:

Andrew MacFaul

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