

5 February 2014

Hannah Nixon
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By email only

Dear Hannah

Re: RIIO-ED1: Informal consultation on licence drafting – Standard Licence Conditions and Informal consultation on fast-track licence drafting – Charge Restriction Conditions (Part 1)

Thank you for the opportunity to respond to the above consultations dated 10 January. I am responding on behalf of the fourteen electricity distribution licensees who are Distribution Services Providers.

This response is not confidential and can be published on the Ofgem website.

We have been working with your licence drafting team since the Licence Drafting Working Group (LDWG) was formed in mid-2013 and considerable work has been done to get the conditions into a position ready for consultation. Although, during the course of the development of the draft licence conditions, there have been a significant number of issues which have been raised, resolved and successfully closed, there are a number which we consider are still outstanding. We have highlighted these in Appendix 6 (attached) and expect that Ofgem will respond specifically to those issues in their consultation decision.

We have set out our main comments in the Appendix 1 to this letter. Where appropriate these comments have also been addressed in Appendix 2 or 3. Appendix 2 is the Standard Licence Conditions and Appendix 3 the Charge Restriction Conditions – these are in track changed format using the versions you issued as a source but with all your changes accepted. Appendix 4 is a log of the relevant track changes where it may not be obvious as to the reason for the change.

Appendix 5 is the track changed Stakeholder Engagement Guidance document, and Appendix 6 is a list of issues from the work done with licensees prior to this consultation where we believe Ofgem have inadvertently closed the issue down. Our feedback on the Data Assurance Guidance document is contained within Appendix 1.

It is inevitable in responding to such consultations that our response focusses on those areas where licensees have particular concerns. We would like to recognise that progress has been made through the efforts of the team at Ofgem and that large parts of the licence are very close to being ready for statutory consultation.

I hope the above and attached provide constructive feedback on the current state of the draft DNO RIIO-ED1 licence conditions and we look forward to working with Ofgem to progress these. With this in mind we are happy to discuss the contents of our response with Ofgem should any points require clarification.

Yours sincerely

A handwritten signature in black ink, appearing to read 'David', with a long, sweeping horizontal stroke underneath.

David Smith
Chief Executive

Cc: Sarah Walls, ENWL
John France and Tony Sharp, Northern PowerGrid
Susan Bradshaw and Stephanie Rogan, SPEN
Sam Ridsdale, SSEPD
Paul Measday and Keith Hutton, UKPN
Natasha Richardson, WPD

DNO Reg Managers plus LDWG members

Appendix 1

1. Absence of appropriate safeguards for licensees against failures in annual iteration processes

Licensees have raised concerns with Ofgem on a number of occasions that a very substantial component of revenues will rely on successful operation of Ofgem's annual iteration process. We remain concerned that the 'emergency MOD' process set out in CRC4B could result in licensees receiving a shortfall in revenues in circumstances where the annual iteration process would enact changes to revenues, due for example to successful reopener processes or increases to tax rates.

Whilst we acknowledge that this shortfall would be redressed in the subsequent year's iteration process, licensees could face substantial financial pressures in the intervening period. It is equally the case that the process would delay price cuts for consumers in the opposite circumstance.

We are also concerned that there are no safeguards in place to address potential circumstances where the Authority fails to direct, or incorrectly directs, variable values. Whilst all licensees will allocate resources to checking draft variable values once issued, we remain concerned that Ofgem will have a very short period of time to make any consequential corrections across all licensees (including gas distribution and transmission) before it is required to direct those variable values and MODt. Licensees believe that there is a significant risk that errors or omissions may occur, given the experience of operating the iteration process in other sectors to date. As many of the variable values can result in changes to base revenues of millions of pounds, a process needs to be introduced to address material errors and omissions in variable values included in calculation of MODt.

2. Unavailability of Regulatory Instructions and Guidance (RIGs), Associated Documents (ADs), the Price Control Financial Model (PCFM) and Price Control Financial Handbook (PCFH)

Through the review of the licence conditions, it has become apparent that, to fully understand some of the conditions and to be able to check that they work, licensees need to be able to see them in combination with the documents they refer to. For example, on the face of it CRC2E on the incentive on customer engagement seems broadly sensible: however, until we have seen the ICE Guidance Document it is hard for licensees to fully appreciate what reporting they are committing to in terms of detail, timescales and accuracy requirements.

This is further exacerbated in a number of the charge restriction conditions, specifically CRC4A and CRC4B, where the lack of a completed Price Control Financial Handbook (PCFH) restricts the checking that is possible.

We propose that conditions that are affected in these ways are subject to a further consultation (preferably prior to the fast track statutory licence modification or alternatively before the slow track statutory licence modification) once the relevant Associated Document (AD), RIGs, Price Control Financial Model (PCFM) and PCFH are available to allow a thorough review.

We note that the draft Data Assurance Guidance that accompanied this consultation does not yet reflect the reporting requirements for RIIO-ED1. Furthermore the document refers to transmission requirements and the trial that licensees are undertaking.

3. Inadequate notice for changes to RIGs and Guidance Documents

Licensees do not accept that the notice period for changes to RIGs or Guidance documents provides sufficient time for licensees to implement system changes or provide staff training required for changes to data reporting, or plan and implement new initiatives to meet revised criteria. The impact of material changes to guidance part way through a regulatory period is potential licence breach for misreporting or breach of data assurance requirements, or failure to meet new criteria relating to incentives or penalties.

Licensees are proposing a default requirement to give at least 3 months' notice prior to the beginning of the regulatory year to which changes apply. This requirement would be caveated such that, with the agreement

of all licensees, Ofgem can reduce the notice for changes that are not material or do not require a longer time period to implement.

4. Inappropriate drafting of the principal charge restriction obligation

CRC2A as drafted requires the licensee to “use its best endeavours to ensure that, in Regulatory Year t, Regulated Distribution Network Revenue is equal to its Allowed Distribution Network Revenue”.

This wording does not permit the licensee to set charges that deliberately under-recover. This is unduly restrictive, especially when it is considered in conjunction with the two year lag on over- and under-recoveries. The formulation being proposed by Ofgem would prevent the licensee using its judgement to set a sensible and stable path of prices.

In the Ofgem LDWG there has been some discussion of the appropriate level of “endeavour” in relation to the duty to set charges that do not exceed the maximum. The licensees have suggested a form of words that would preclude the licensee from setting charges that were more likely to over-recover than under-recover but that would not prevent a licensee from setting charges that were likely to yield an amount that is below the maximum permitted.

We note that Ofgem are still considering our suggested drafting and commend our alternative drafting to Ofgem.

Our intention is not to soften the nature of the duty: it is to ensure that the duty correctly expresses Ofgem’s policy intent.

5. Status of legacy workbook unclear

We are concerned that there is no formal legal status given to the Legacy Workbook, even though this has a significant effect on allowed revenues. The Financial Handbook is not in a sufficiently advanced state to provide the governance of the Legacy Workbook that licensees had expected. As a result we require the Legacy Workbook to be recognised in CRC4A and in the Financial Handbook with an associated process for modifying the Legacy Workbook.

6. Unclear policy with respect to the losses obligation

We are concerned that Ofgem’s policy intent relating to DNO obligations in respect of the theft of electricity is unclear in the drafting, in particular in the area of DNO’s legal powers under the Electricity Act. We have provided alternative drafting that we hope will clarify the matter. Given that it is Ofgem’s policy that suppliers have the main responsibility for theft of electricity it is important that DNOs are clear exactly what they are responsible for under their licence.

7. Data Assurance Guidance (DAG)

In order to be suitable for RIIO-ED1 and the licence drafting process the DAG must be updated in its entirety to reflect the process to be followed during RIIO-ED1 and not the DPCR5 trial process. There are numerous references to Transmission and Gas licensees instead of Distribution which either need to be removed or expanded to also include Distribution. The submission list in Appendix 1 (to the DAG) requires a review to reflect the obligations under RIIO-ED1 and their associated licence reference. We consider that a DAG working group meeting will be required so we can discuss with Ofgem: the overall success of the trial; any amendments necessary to the DAG for ED1 use; and any feedback from Transmission and Gas licensees to ensure the frameworks are as aligned as practically possible, before the documents can be fully agreed. Accordingly a full mark-up response has not been supplied.

8. Duplication of reporting/review reporting timeline of all submissions

Once all the ADs, RIGs etc. have been completed we support Ofgem conducting a review of the reporting requirements so as to avoid, wherever possible, the duplication of reporting of data. This would fulfil a commitment made by Ofgem at the ENA Electricity Regulation Group in January 2014. Such reporting places the licensee at a greater risk under the Data Assurance requirements of the RIIO licence and also increases the regulatory burden on licensees in their production and on Ofgem in their review of the submissions. Such a review should also map out the timeline of reporting of all submissions to Ofgem so as to ensure interlinks and dependencies are understood. The reprofiling of the timing of submissions can be considered so as to avoid reporting pinch points or short timescales for submissions to be prepared, reviewed and approved under the Data Assurance requirements.

9. Lack of clarity regarding network asset indices methodology process

We have found it very hard to review the network asset indices licence conditions in the absence of the network assets workbook. We require more detail from Ofgem on the content of this workbook and its intended usage.

The current drafting of SLC51 and CRC5D implies but does not explicitly state that any “translation” of the licensee’s Network Asset Secondary Deliverables as a result of the implementation of the Common Network Asset Indices Methodology must not result in any change to the licensee’s physical deliverables. The licensees require this to be on the face of the licence.

10. Adjustment of the correction factor to cover recently announced rebates

As drafted CRC2A.17 states that in the Regulatory Year 2015/16 k_t will have the value of zero.

This needs to be changed to allow licensees to recover the rebates that have recently been announced and that will be subject to the various consents that have been or are shortly to be issued by Ofgem.

It would be straightforward to amend the drafting of CRC2A.17 so that k_t in 2015/16 has a value determined by the Authority in a manner that is consistent with the various consents referred to above. Consequential changes may also be necessary to subsequent years.

11. Difficulty in replicating data in appendices for fast track licensees

In a number of instances, licensees have been unable to replicate key numbers quoted in the published draft licence. In some cases the differences between the values we expected and the quoted values are quite significant. It would be very helpful if Ofgem could provide licensees with a schedule setting out the calculations used so that they can provide feedback on those calculations.

12. Work required on definitions

Work is needed to cross check definitions between the SLCs, CRCs, the Financial Handbook and the RIGs to ensure consistency. We note that quite a number of suggestions made by DNOs have not been enacted yet.

13. Lack of process for IFI/LCNF T1 projects which overlap price control periods

We note the omission, from the draft licence conditions in this consultation, of a transitional process from the current IFI and LCNF Tier 1 arrangements to those proposed for RIIO-ED1. There are likely to be a number of projects commenced during the DPCR5 period but not completed until early in the RIIO-ED1 period and it is critical that those projects which overlap between DPCR5 and RIIO-ED1 can continue under the DPCR5 arrangements until complete. This is particularly important as the arrangements do not simply affect licensees but also those parties with which licensees contract as part of the innovation project. Without certainty that the arrangements in place at the start of the project will remain in place until completion, it will be virtually impossible for licensees to contract with third parties and deliver those

innovation projects which overlap DPCR5 and RIIO-ED1. We expect that Ofgem will provide clarity on the transitional process in their consultation decision.

14. Absence of clarity on the application of inflation to values from 2012/13 prices

DNOs have asked Ofgem to confirm that it is Ofgem's policy that all values given at 2012/13 prices will have the inflation factor applied to bring them up to price base at the time of performance, even where there is no explicit formula to provide for this (except in circumstances where the licence algebra explicitly specifies otherwise).

15. Opportunity to review SLC12/15

We note that this consultation does not include the above standard conditions. We anticipate the need for these conditions and their associated documents to require updating to enact ongoing discussions in RIIO working groups and look forward to working with Ofgem to achieve these aims.