

Hannah Nixon
Senior Partner, SG&G: Distribution
Ofgem
9 Millbank
London
SW1P 3GE

7 February 2014

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

Dear Hannah

Thank you for the opportunity to respond to the above consultations dated 10 January. This response should be regarded as a consolidated response on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc. For convenience, the three licensees are collectively referred to as "UK Power Networks" in this response. Please note that our response is not confidential and can be published via the Ofgem website.

UK Power Networks has 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. However, we are concerned that there has been a focus on hitting the commitment to the two consultation dates (10 January and 31 January) at the expense of due process and quality of drafting. This is borne out by the volume of comments in the ENA response and also those that we cover in this letter.

We will continue to work with you and your team to ensure a fit for purpose licence is available for all DNOs as this is in Ofgem's, stakeholders' and the DNOs' interests

The issues that UK Power Networks feels specifically strongly about are covered in the appendix to this letter. We wish to draw your attention to three of these issues:

- UK Power Networks requires sufficient time to be able to implement any future changes (in IT systems and supporting processes) to the RIGs;
- the introduction of the new cost adjustment mechanism in respect of gross to net connections adjustment; and
- the potential significant risk of future changes to the network asset indices methodology and its implications for UK Power Networks' business plan delivery.

In all three cases we are concerned that there has been insufficient discussion with Ofgem's policy teams and recognition of the concerns that UK Power Networks and other DNOs have.

I hope the above combined with the detailed response in the appendix to this letter coupled with the ENA response and its associated appendices (that I can confirm we support) provide constructive feedback on the current state of the draft RIIO-ED1 licence conditions and we look forward to working with Ofgem to progress these.

Yours sincerely



Keith Hutton
Head of Regulation
UK Power Networks

Copy Anna Rossington, Ofgem
Jane Jellis, Ofgem
Tom Mackenzie, Ofgem
Basil Scarsella, Chief Executive Officer, UK Power Networks
Ben Wilson, Director of Strategy & Regulation & CFO, UK Power Networks
Barry Hatton, Director of Asset Management, UK Power Networks
Mark Adolphus, Director of Connections, UK Power Networks
Matt Rudling, Director of Customer Services, UK Power Networks
Richard Roberts, Director of Finance, UK Power Networks
Murdo Allan, Director of Health, Safety & Sustainability, UK Power Networks
Patrick Clarke, Director of Network Operations, UK Power Networks
Paul Measday, Regulatory Returns & Compliance Manager, UK Power Networks

Appendix

RIGs 3 month notice

We strongly believe that to ensure as complete and accurate (as far as is possible) submissions a restriction on the timescales to change RIGs is required. We have discussed at the LDWG that it is important for DNOs to be given adequate time to change their systems in response to any updates to the RIGs. We propose that any changes must have their formal consultation completed and the direction issued by 31 December in year x for compliance by the DNO starting on 1 April in year x+1 and reporting on in year x+2.

The requirement for such a restriction has been borne out by experiences in DPCR5 and in the RIIO-ED1 Business Plan submission process: our business plan submission was driven from our business as usual management systems and all our costs and volumes were reconciled and auditable to these systems. There have been proposed changes in the RIGs guidance notes that require companies to change the way that they record costs. In order for a DNO to be able to accurately record and have an auditable data set they require a minimum of 3 months to implement the change in systems and a further 12 months to collect the necessary data. Such an example of this was the change to Ofgem's requirement to include ongoing efficiencies on a line by line basis within the relevant RIGs tables. This is particularly important given Ofgem's increased focus on data quality.

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 the conditions and to be able to check that them you need to be able to see them in combination with all supporting documents. For example, on the face of it SLC47 on environment reporting seems broadly sensible, however until we have seen the Environment Report Guidance Document (ERGD) it is hard for DNOs to fully appreciate what reporting they are committing to in terms of detail, timescales and accuracy requirements.

This is further exacerbated by 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.

Status of legacy workbook unclear

Although discussions on this matter were held with Ofgem at the LDWG on 23 January we would like to reemphasise the need for appropriate governance on this document due to the scale of the potential impacts should values in it be changed. It is currently without any governance and DNOs are exposed to potential changes of interpretation by Ofgem of the DPCR5 final proposals (which are in part enacted through the workbook). The governance needs to be proportional to the risk and mindful of the potential workload to bring the workbook up to the same level of governance as the PCFM. As such, one option is to embed on the face of the licence a requirement for Ofgem to consult with DNOs on any changes to the workbook or numbers in it and consider any

representations made by DNOs in response to the consultation. Such requirements and the wording behind them already exist for other documents so should be easy to implement.

Issues closed on log

Throughout the life of the LDWG DNOs have been diligently completing a log of changes and corrections required to the licence condition. On review of the log issued to DNOs in parallel with the consultation we note that a number of issues have been closed by Ofgem that either have not been correctly implemented by Ofgem or where Ofgem's opinion is different to DNOs so the issues have been closed without full debate. This list forms part of the ENA response and we believe should be reviewed by Ofgem and answers provided to each issue.

By way of an example we refer to issue number 46 under SLC45 whereby DNOs sought clarity on the face of the licence in respect of ensuring the same version of the Data Assurance guidance document was to be followed when a change had been made to the document between the two reporting deadlines. This is to ensure consistency of the two reports but the issue was closed and referred to be clarified in the guidance document. We strongly believe that something as important as this should be on the face of the licence, but that aside it should not have been closed, it should have been left open until the guidance document had been finalised to ensure the point was not lost.

SLC12/15

Although not part of the conditions that Ofgem are currently consulting on, we are supportive of a review and refresh of the above conditions as part of the RIIO licence updating process. Taking them in numerical order:

- SLC12 – this currently places an absolute (100%) obligation on DNOs to issue quotations within three months of receiving all the relevant information from the connections customer. This absolute obligation results in one single failure meaning a breach of licence and we believe that is disproportionate and not in line with other conditions. UK Power Networks issued approximately 33,000 quotations in 2012/13. However, we fully understand the importance of this condition and its backstop nature and as such propose an obligation in the 99% compliance range with suitably scaled compensation arrangements for any failures to meet the three month standard.
- SLC15 – we understand that the guidance document for this condition is to be brought up to date (it currently refers to the condition by its previous number of SLC4F) and at the same time will be amended to change it from a guidance document into a RIG. We support this but also propose further modifications to the document and also changes to the condition itself. These changes are required as a result of the developments in the competition in connections arena and the move to making a number of areas of work contestable. As such the volumes of jobs in each category have diminished such that in some cases there are only single digit volumes of work per category (for example in LPN Q1, Q2 and Q3 combined volume in 3(a) standard is only six jobs). In such cases one failure in such a category would breach the 90% (per category) licence compliance test. We are happy to work with Ofgem to consider what categories could be logically merged to enable SLC15 and its new RIG fit for purpose in light of developments in this arena.

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. Such reporting places the DNO at a greater risk under the Data Assurance requirements of the RIIO licence and also increases the regulatory burden on licensees. 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 and the re-profiling 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.

The need for this review can be illustrated by the current requirement for DNOs to submit HI and LI data in September even though the RIGs themselves state a 31 July deadline. The need for the September deadline is due to the timescales required for DNOs to process the data, however such a restriction was not seen at the time resulting in DNOs and Ofgem having to work under a side letter to submit this data at a different time to that specified in the RIGs.

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-recovery 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.

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.

Process for inflight IFI/LCNF T1 projects

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.

Gross to Net

We understand that this has been developed to cater for paragraph 8.30 of the incentives and outputs appendix which formed part of the March 2013 RIIO-ED1 strategy document.

We believe that the paragraph is unclear as to the policy requirement and as such the policy has been developed through the LDWG and not through due process via an appropriate working group. Accordingly our current interpretation of this condition is that it attempts to net (from load related allowances) any expenditure received from connection customers above what has been agreed in the final ED1 revenue determination. If this understanding is correct than as currently worded UK Power Networks does not believe that Ofgem are fully taking into account the benefit general customers receive when additional capacity is funded through connection charge capacity rather than agreed load related allowances. In general connection customers only pay for the capacity they use and any additional capacity continues to be funded through DUoS and therefore UK Power Networks does not understand why this condition has been inserted. There has been little opportunity to debate this policy change and therefore UK Power Networks believe it should be removed,

Losses Obligations

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. Through the LDWG, DNOs have provided alternative drafting that we hope will clarify the matter although this has yet to be used. Given that it is Ofgem's policy that suppliers have the main responsibility for theft of electricity it is important that it is clear what we are responsible for under our licence.

Network Asset Indices Methodology (HIs and LIs)

The production of the business plans through the RIIO process has been conducted using DNO specific network asset indices and allowances have been set against these. We understand and support the need to move to a common methodology however we are concerned that there is currently potential for DNOs to sign up to one set of deliverables (with associated cost allowances) but then be assessed against a common and different set of deliverables whose costs will not have been allowed for.

Clarity is required on how the differing indices and their associated allowances will be reconciled. Furthermore confirmation is required that the mechanism that will be used for judging a DNO's performance will be against their business plan commitments and the underpinning assumptions.

Stakeholder Engagement

We can confirm that in addition to the feedback on the stakeholder engagement document provided by the ENA, we will continue to engage with James Veaney and his team via the Customer and Social Issues Working Group (CSIWG) to further develop this document as has already commenced following the CSIWG meeting on 22 January.

SLC50 Business Plan Reporting

As currently drafted the SLC50 Business Plan Reporting obligation is set against the July 2013 submission by DNOs. For slow track companies this is not appropriate and the obligation should be set against a revised set of output commitments consistent with the final determination such that a DNO is not required to explain in its annual reports that it is unable to meet its commitments as it has not been funded to do so. For example our business plan commitment to reduce oil leakage volumes is dependent on Ofgem approving our fluid filled cable replacement plans.

Data Assurance

As drafted the Data Assurance documents issued refer to reporting on conditions that form part of the DPCR5 licence and the guidance itself is littered with references to transmission and gas distribution. Furthermore these documents are currently part of a voluntary trial being conducted by distribution licensees and as such are still being developed. We therefore believe a separate consultation should be conducted at the end of the trial to review its success and the working of the DAG before there are finalised and implemented in RIIO.

We also feel it is appropriate to note that the DAG itself will not ensure perfect returns, it will instead help licensees identify weaknesses in the production or their returns to continually improve the accuracy of them.