

29 April 2014

Hannah Nixon
Senior Partner Distribution
Smarter Grids and Governance: Distribution
Ofgem
9 Millbank
LONDON
SW1P 3GE

By email only

Dear Hannah

**Re: RIIO-ED1: response to RIIO-ED1 statutory consultation on WPD
CRCs and all DNO SLCs**

Thank you for the opportunity to respond to the above consultation dated 28 March 2014. I am responding on behalf of the ten electricity distribution licensees who are Distribution Services Providers and who have not been fast-tracked in the RIIO-ED1 process.

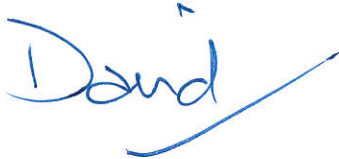
We have chosen to respond to this consultation as we have worked closely with your team over the last year to refine drafts of the conditions and handbook and it is in all our interests to ensure they accurately reflect policy. However, it has been harder this time to respond as we have now reached the formal statutory consultation and are not yet able to see the full picture of conditions and associated documents to consider them as a whole package.

We have set out our main comments in Appendix 1 to this letter. Appendix 2 contains a track changed version of the Financial Handbook, Appendix 3 is a track change of the Charge Restriction Conditions (CRCs) and Appendix 4 is a track change of the Standard Licence Conditions (SLCs).

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

I hope the above and attached provide constructive feedback on the DNO RIIO-ED1 licence conditions and Financial Handbook and we look forward to discussing our feedback with you.

Yours sincerely

A handwritten signature in blue ink that reads "David". The signature is stylized with a long, sweeping underline that extends to the right.

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
Roger Barnard, Legal Consultant

Appendix 1

General Points

1. Inappropriate timing of modification of standard licence conditions and potential for discrimination

We are concerned that, if the Authority formally makes the proposed modifications to the standard conditions before the final settlement to which those conditions would be intended to give effect has been established for the slow-track licensees, this will effectively deny those licensees any meaningful rights of appeal against the modifications. This is because, by the time that the final settlement is completed for the slow-track licensees, their rights of appeal against the modifications will have been timed out under the relevant legislative provisions.

It should be noted that this denial of appeal rights would apply not just in relation to these modifications intrinsically, but also to the modifications insofar as they are capable of being characterised by the Competition and Markets Authority as price control modifications attracting an appeals procedure that is different from that for licence modifications that do not relate to decisions that give effect to what the statute calls 'a price control decision'. Only the fast-track licensees would be in a position to decide whether to exercise appeal rights with full knowledge of the settlement in respect of which those licence modifications were being made. We believe this would be discriminatory and not in accordance with good regulatory practice.

Furthermore, it is conceivable that some standard conditions may need to change as a result of the slow-track process and we consider that, by holding a statutory consultation on these conditions at this time, Ofgem has effectively pre-judged the outcome of the slow-track process. We do not consider these standard conditions to be necessarily the fixed and final versions that will emerge at the end of the price control review process.

2. Master list of associated documents and version numbers required

With the additional volume and complexity of associated documents that are being produced for RIIO, we believe that having a master list of each document, with a version number and issue date, would benefit not only licensees but also customers and external stakeholders. This would minimise the risk of an incorrect version of a document being followed by a licensee and also enable all parties to ensure that they have the latest version to hand. To gain the most from this, such a list would best be placed on the face of the licence with a self-modification process for the document version, number, and date such that each time a document was updated the master list would also be updated.

SLC Points

1. Inadequate notice for changes to RIGs and Guidance Documents

We 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 to 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 contravention for misreporting or breach of data assurance requirements, or failure to meet new criteria relating to incentives or penalties.

We are proposing a default requirement to give at least three 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 could reduce the notice for changes that are not material or do not require a longer time period to implement.

2. Licence Conditions with a looking-forward and looking-back report must allow reporting for same time period to be on same basis

We believe that, where a condition or its associated document requires the production of a forward-looking report and a backward-looking report, then both reports for the same regulatory year should be based on the same version of the associated document. This will ensure that both reports are able to be written and therefore read in a logical manner. To have them based on different versions of the associated document also leads to the potential that licensees could be placed in inadvertent breach of licence by not being able to comply with something required of the backward-looking report as it was not a requirement to have it in place at the time of producing the forward-looking report.

It should also be noted, further to the cross-sector Data Assurance Guidelines (DAG) meeting on 16 April 2014, that the DAG condition may need to be revisited if the DNOs' proposal for the report to cover a 'specified period' rather than a 'regulatory year' is accepted.

3. Removal of reporting dates from the face of the licence to facilitate any future changes to timing

To enable any output of the review of reporting dates that has just commenced to be enacted, we believe it is sensible to remove any reporting dates from the face of the licence and place them in the associated document, RIGs or guidance document (e.g. SLC47's Environmental Report Guidance Document). Where no such document exists (or is planned to be created) then the dates should stay on the face of the licence (e.g. those in SLC51 in respect of the submission of a Common Network Asset Indices methodology).

4. Clarity surrounding the definition of Working Day

There have been a number of iterations as to the inclusion of the term 'working day' through the development of the licence to date. Having taken a step back and considered the definition afresh, we believe that the correct way of proceeding in this respect is to:

- i) remove the existing definition of Working Day from standard condition 1;
- ii) remove the England-and-Wales-related definition of Working Day from CRC 1B; and
- iii) then amend standard condition 1 by adding the term Working Day at the very end of the list of Electricity Act terms in paragraph 1.4 of that condition.

While this is only a clarifying exercise, the point is not trivial as it relates to at least 15 uses of the term 'working day' in the CRCs alone.

CRC Points

1. The need for consultation with stakeholders regarding adjustments under CRC4C

As currently drafted, there is no requirement for the Authority to consult with stakeholders, including Distribution Services Providers other than WPD, on the proposed adjustments to be made under CRC4C (Price control update provisions for WPD). These adjustments have the potential to be material in quantum and to be complex to calculate. We therefore believe that wider consultation is required on these adjustments and for Ofgem to take account of representations received.

We also believe that it would provide greater clarity for stakeholders if the following potentially material adjustments that are expected to be made were included as Stipulated Values under Part A of this condition rather than within the general provisions under Part D:

- Updating WPD's attribution of qualifying expenditure to capital allowance pools for tax allowance purposes to the common basis to be used by all DNOs
- Updating of RPI assumptions within the PCFM to align with those of other DNOs
- Updating of the Network Innovation Allowance percentage

2. Interaction between Load Related and Net: Gross conditions needs aligning

Conditions CRC3G (Revising the allowed level of Load Related Expenditure) and CRC5G (Net to gross adjustment for Load Related Expenditure) have the potential to make adjustments relating to the same activities, leading to the potential for a double count of adjustments.

This is recognised in the drafting of both conditions by allowing that, if both mechanisms are triggered, the combined effect of both will be included in the direction of load related variable values.

Relevant excerpts:

3G.13:

'A Notice given by the licensee under paragraph 3G.6 must set out:
(b) any consequential change to the licensee's Specific Customer Funded Reinforcement Percentage Band specified in Table 2 of CRC 5G that is proposed by the licensee.'

3G.20:

'In determining any relevant adjustment under paragraph 3G.17 and 3G.18, the Authority will:
(e) consider whether the licensee's Load Related Expenditure has fallen outside any Specific Customer Funded Reinforcement Percentage Band under CRC 5G.'

5G.7

'Where the Authority gives notice of proposed relevant adjustments under paragraph 3G.13 of CRC 3G (Revising the allowed level of Load Related Expenditure), the licensee in question will not be subject to an additional net to gross Load Related Expenditure adjustment.'

However, these fail-safe provisions may work incorrectly as currently drafted because the adjustments under 5G are finalised in November 2023 and those under 3G in November 2024. We propose that this mismatch is corrected by ensuring that both adjustments are directed in November 2024. This will allow the safeguards that are currently included in the licence to operate correctly.

3. Change required to align basis of assessment of Network Asset Secondary Deliverables to Ofgem's published strategy

The current drafting of CRC5D refers (in paragraph 5D.6) to the assessment of a licensee's performance as being 'the licensee's delivered change as measured in accordance with the Network Asset Indices'. This wording suggests that the assessment is made against all three Network Asset Indices set out in paragraph SLC51.4.

Paragraphs 6.5 and 6.6 of Ofgem's reliability and safety decision (26f/13) make it clear that this assessment is to be based on the Risk Index. Paragraph 5D.6 should be updated to refer to 'Risk Index' rather than 'Network Asset Indices' to align with Ofgem's published strategy.

4. An issue with definition of 'Ordinary Business Arrangement' (in CRC 3D – Innovation Roll-out mechanism)

We note in the log that Ofgem provided feedback in respect of the changes we proposed to the definition of Ordinary Business Arrangement (to change 'a licensee' to 'the licensee' in the closing sentence). Ofgem stated that, as currently drafted ('a licensee'), it is correct such that 'if another licensee is using something in the course of its ordinary business without making use of the IRM then the other licensee should be able to'. We understand this position: however, if DNO1 uses the IRM to fund something then DNO2 cannot then use the IRM to fund the same something as it will be being used by another licensee. The definition of ordinary business arrangement precludes use of the IRM when the something is being used by another licensee either inside or outside the IRM, which in turn may curtail the implementation of key innovations needed to support the move to a low-carbon economy to one licensee per innovation.

5. Clarity required on meaning of 'nullify the specifications in the original Notice' in CRC2B

We note that, in CRC2B.16, the phrase 'nullify the specifications in the original Notice' is used. We are unclear as to the precise meaning of this phrase and query whether it is only the contents of the Notice that are being nullified or both the contents and the consequences of the Notice. The underlying question here is, does the nullification restore the position to that which existed before the original Notice was issued and, if so, how are the effects of that to be recognised and treated?

6. Inappropriate removal of deeming paragraph from CRC5B (legacy metering)

The version of CRC5B (Restriction of charges for the provision of Legacy Metering Equipment) that was issued as part of the Part 1 consultation in January 2014 contained (as its predecessor had done) a deeming paragraph in the form of CRC5B.24:

'If the Authority has not determined the relevant adjustment factor within 28 days of receiving the licensee's Notice, and that Notice has not been withdrawn, the licensee may apply the relevant adjustment factor in the manner specified in paragraph 5B.18 for the duration of the Adjustment Period.'

The version issued as part of the statutory consultation does not have this paragraph in it, nor is its removal track-changed. We request that this paragraph is reinstated as its removal has not been signalled or justified.

7. Problematic Recovery of £5 Reductions

There are substantial differences as to how £5 rebates will be accounted for across DNOs as a consequence of differences in consented arrangements. As drafted in licence condition CRC2A, the correction factor revenue adjustment (Kt factor) will not correctly cater for all agreed permutations (because, for example, it will have a value of zero in 2015/16). Therefore, going forward, we propose that this is addressed as a DNO specific CRC mechanism as part of the slow track process.

Handbook and PCFM Points

1. Ambiguity of detailed mechanisms associated with the annual iteration process

We remain concerned that the Financial Handbook does not, in many instances, include sufficient detail to ensure unambiguous interpretation of the mechanisms that must operate during the direction of Variable Values and MOD.

In particular, further work is required to ensure that full transparency is achieved as to whether adjustments are expected to over-write existing values in the PCFM or whether they are intended to be added to the pre-existing values. In some instances, for example the basis of starting Variable Values for the Totex Incentive Mechanism, the wording in the Financial Handbook is not consistent with the data populated in WPD's PCFM. In other instances, for example throughout adjustments in the pensions chapter, the processes seem to confuse calculations of 'over-write' values with 'delta' values, inappropriately suggesting a hybrid calculation.

2. Lack of detail in Chapters 7-12

We were disappointed that the Financial Handbook, from Chapter 7 onwards, contains significantly less detail than the licence even though this point was brought up in our response to the 'informal' consultation. As previously mentioned, it was envisaged that the Financial Handbook would be a 'how to' for the PCFM and would set out processes, timescales and accountabilities for the various calculations and tasks that require completion. At present, Chapters 7 onwards do not add anything to the information set out in the licence and we would urge Ofgem to address this deficiency.

3. Further improvement required to pensions chapter

We acknowledge that the drafting of the pensions chapter within the Financial Handbook has progressed since your informal consultation. However, a number of issues require resolution. In particular:

- The handbook drafting fails to ensure the full recovery of any adjustments associated with DPCR4 close-out; and
- The newly introduced drafting is, in some cases, unclear and can be interpreted in a number of ways.

4. Details of allocation of activities to tax pools required in handbook

We note that licensees' request to include details of the allocation of activities into the seven subdivisions to facilitate varying tax pool treatments has not been accepted.

While we welcome Ofgem's acknowledgement that *'If a change is made to the categories of costs included in each subdivision through the operation of a licence condition or otherwise, the Authority will consider whether it is appropriate also to make changes to the financial treatment of such cost category under the Annual Iteration Process,'* this is insufficient to protect licensees from potentially significant changes to the RIIO-ED1 framework.

The move to operate the Totex Incentive Mechanism for RIIO price controls on a post-tax basis means that changes to tax allocations can have a potentially large effect on the incentive properties of the price control, with the potential for incentives to be rewarded on a basis that is different from the way in which allowances were made.

The inclusion of a simple table within the handbook allocating activities, based on BPDT definitions, to tax subdivisions would be sufficient to give licensees comfort that if significant changes were made to allocations then the DNO would have recourse via CRC4A to seek a statutory consultation on the changes. Clearly, if the changes were not significant then they could be made via the self-modification processes for the Financial Handbook.

5. Issues with Price Control Financial Model

A number of issues remain with the formulae within the Price Control Financial Model. These are mainly of a minor nature. We believe that these issues are best addressed at a meeting of the PCFM Working Group. We note and appreciate that Ofgem has now called a meeting of this group, but we feel it appropriate that any output from this meeting should be taken as part of the response to the statutory consultation.