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Dear Grant

**Informal consultation on changes to the RIIO-ED1 Financial Handbook to enact DPCR5 Close Out**

Thank you for the opportunity to comment on your proposed modifications to the RIIO-ED1 Financial Handbook to enact the close out of certain DPCR5 mechanisms. It is very helpful to have the opportunity to review the consolidated set of proposed modifications in the way that you set out in your consultation.

The quality of the proposed modifications to the Financial Handbook has improved over recent months as a result of the processes that you have followed as part of your Licence Drafting Working Group. The methodologies that you intend to follow are now more clearly articulated and are more consistent with the expectations set out in the DPCR5 Final Proposals. However, a small number of significant issues remain that must be addressed prior to your statutory consultation on these modifications.

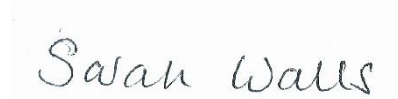
Additionally, in a number of places the proposals are drafted in an imprecise way. This leads to a small number of instances where key aspects of the Authority's proposals can be interpreted in more than one way or where the Authority's intent is not clear. These should also be reviewed prior to the statutory consultation.

I append two annexes setting out the issues that I refer to.

We will continue to work with Ofgem to finalise these modifications and would be willing to review the proposed changes to address the issues we raise prior to the statutory consultation.

If you have any questions regarding our response please do not hesitate to contact me.

Yours sincerely



**Sarah Walls**  
**Head of Economic Regulation**

## **Annex 1 - Significant issues in proposals**

### **1. Absence of a formal step to conclude process early following Initial High Level Analysis.**

The proposed methodologies do not include a step after July 2016 to formally stop the assessment process for an aspect of DPCR5 Close Out if the Authority's Initial High Level Analysis shows that no adjustment is needed.

The absence of this step exposes DNOs that have delivered for customers over the DPCR5 period to the risk of unexpected revenue adjustments that are proposed by the Authority in February 2017 after the licensee's opportunity to submit a Performance Assessment Submission (PAS) has lapsed.

This issue could be resolved by added an extra sentence to each of paragraphs 15.7 and 16.7 setting out that 'If the Authority's Initial High Level Analysis concludes that no adjustment is appropriate under one or more methodology the Authority will notify the licensee in Writing that it will make no revenue adjustment for those aspects.'

### **2. Incorrect definitions of Post-Threshold Amount applied in reopener calculations**

The definitions of Load Related Post-Threshold Amount and HVP Post-Threshold Amount do not operate correctly in circumstances where the licensee has spent less than 80% of its allowance.

In these circumstances the definition requires that 'the portion of total DPCR5 expenditure that is ..... below a figure calculated as 80 per cent of the DPCR5 Aggregate Baseline Expenditure Allowance figure' is to be used in revenue adjustment calculations. In the circumstances where a DNO has spent less than 80% of its allowance then all of its total DPCR5 expenditure will be less than 80%, resulting in the whole of the licensee's expenditure being inappropriately disallowed and returned to customers.

This issue can be resolved by amending the defined term so that for underspend situations it is calculated based on the saving against allowance rather than the expenditure, for example:

HVP Post-threshold Amount:

The portion of total DPCR5 expenditure that is above a figure calculated as 120 per cent of the DPCR5 HVP Aggregate Baseline Expenditure Allowances figure (for circumstances of overspend) or

The portion of difference between total DPCR5 expenditure and DPCR5 HVP Aggregate Baseline Expenditure Allowances that is greater than 20% of DPCR5 HVP Aggregate Baseline Expenditure Allowances (for circumstances of underspend).

### **3. Description of Innovative Solutions used in PAS annex is inappropriately narrower than defined term**

The description of the types of Innovative Solution that the licensee is permitted to include in its PAS is limited to Innovative Solutions deployed to avoid reinforcement (para 5.14 of Annex E). This should be broadened to also allow inclusion of Innovative Solutions designed to address reinforcement requirements or defer reinforcement.

#### ***4. Interaction with RAV Rolling Incentive (RRI) is incorrectly applied***

The RRI mechanism in section (i) of Chapter 16 has not been updated to reflect the changes set out in other aspects of this consultation. It fails to include an additional adjustment in the calculation of 'adjusted total capex allowance' to reflect the new flooding mechanism for SSEH. It would also be helpful to cross reference the adjustments to allowances for load reopener and HVP reopener to the specific paragraphs so that it is clear to readers that it is the post-double count adjustment allowance changes that must be used in this calculation.

## **Annex 2 - Areas where unclear drafting leaves scope for significant misunderstanding**

### ***1. Ambiguous wording regarding how High Value Project (HVP) outputs are taken into account in NOMs Failure to Deliver Outputs Methodology***

The NOMs Failure to Deliver Outputs Methodology sets out at paragraph 1.7 that the Authority will ‘take account’ of Interventions carried out as part of High Value Projects as part of its close out of NOMs. This paragraph could be read as suggesting that Interventions delivered as part of HVPs are to be included in the NOMs calculations, however we assume that the Authority’s intent is that Interventions delivered via HVPs will be excluded from the NOMs methodology.

### ***2. Unclear wording creates confusion about scope of adjustments for delayed HVPs***

The HVP Reopener Legacy Assessment Methodology allows at step 4 for the Authority to consider making adjustments to take account of project delays and deferrals. However, it fails to constrain the scope of these adjustments to those projects that have been deferred or delayed into a later price control period. This could be interpreted to suggest that the Authority plans to make adjustments to take account of delays within the DPCR5 price control period.

It would not be appropriate for the Authority to make adjustments for re-profiling of projects within the DPCR5 price control period. We suggest that the drafting be modified to clarify that this adjustment is intended to only apply to delays and deferrals of projects into the RIIO-ED1 price control period.

### ***3. No documentation of how different categories of HVP should be mapped to each of the two Real Price Effect (RPE) indices***

The HVP Reopener Legacy Assessment Methodology correctly includes at paragraph 1.30 a table setting out the indices to be applied to ensure that calculations are based on the level of expenditure that would have been incurred if the licensee had experienced the RPEs forecast in the DPCR5 Final Proposals. However, the table labels the second index as ‘Asset replacement’ rather than the broader ‘Non Load related’ term that it is intended this index should be applied to. This could be interpreted to suggest that projects such as BT21CN projects should not be subject to indexation, whereas our expectation is that the ‘Asset replacement’ index will also be applied to this type of project.

We suggest that the table is amended to include details of all types of project that each of the two indices is to be used for in order to avoid any confusion.