

To: Electricity Distribution
Network Operators; interested
stakeholders

Date: 30 November 2017

To whom it may concern,

Notice of decision to revise allowed expenditure for Link Box Costs under special condition CRC 3F

Ofgem introduced a number of uncertainty mechanisms for costs that were uncertain at the time of establishing the first RIIO electricity distribution price control (RIIO-ED1), which runs from 1 April 2015 to 31 March 2023. This includes re-opener mechanisms, which enable adjustments (up or down) to Electricity Distribution Network Operator (DNO) allowances to accommodate costs associated with specific uncertain cost categories. These mechanisms are set out in Special Condition CRC 3F¹ of the Electricity Distribution Licence.

Link Box Costs was one such uncertain cost category, specifically the costs incurred or expected to be incurred by the licensee in efficiently managing the asset risk associated with Link Boxes.

One of the fourteen DNOs, SP Manweb Plc (SPMW), which is part of Scottish Power Energy Networks (SPEN), gave notice to Ofgem of a proposed relevant adjustment of £28.2m (in 12/13 prices) for the period 2017/18 to 2022/23. The level of additional funding requested exceeds the required materiality threshold in order to trigger an adjustment for Link Box Costs (£5.82m).²

Additionally, Ofgem gave notice to South Eastern Power Networks Plc (SPN), which is part of UK Power Networks (UKPN), of a proposed a downward adjustment of £7.74m (12/13 prices). We proposed an adjustment of £6.42m and £1.32m for Regulatory Years 2015/16 and 2016/17, respectively. This is greater than the material amount of £6.52m³ and less than the maximum possible negative adjustment of £10.68m⁴.

We recently consulted on our minded-to position with regard to the proposed adjustments,⁵ which was to adjust SPMW's allowances by £23.4m and make no adjustment to SPN's allowance. This letter sets out our decision on the adjustment to those DNOs' revenues.

We received three responses to the consultation; these have been published on the Ofgem website⁶. All three responded to the proposal not to make an adjustment for SPN and two

1 Charge Restriction Condition 3F: Arrangements for the recovery of uncertain costs.

2 As specified in Appendix 5 to CRC 3F of the special licence conditions.

3 As specified in Table 1, Appendix 5 in CRC 3F of the special licence conditions.

4 As specified in Table 2, Appendix 5 in CRC 3F of the special licence conditions.

5 https://www.ofgem.gov.uk/system/files/docs/2017/10/open_consultation_letter_link_boxes.pdf

6 <https://www.ofgem.gov.uk/publications-and-updates/consultation-our-minded-position-revise-allowed-expenditure-link-box-costs>

responded to SPMW's proposed adjustment. All three respondents were in agreement with our minded-to position for SPN, and the two respondents to the proposed adjustment for SPMW also agreed with our minded-to position. Annex A provides further detail of the responses.

No further evidence has come to light since the publication of the consultation. Based on our analysis of SPMW's application and the responses received, we have decided to maintain our minded-to position and adjust SPMW's allowances by £23.4m (12/13 prices) as set out below. We consider that the submitted volumes of Link Boxes to be replaced by SPMW is acceptable and in consumers' interests.

SPMW adjustment profiled over RIIO-ED1 (12/13 prices) (£m)

2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	RIIO-ED1 total
1.17	3.22	4.12	4.71	4.71	5.47	23.4

Similarly, based on the evidence submitted by SPN and the responses received to the consultation, we have decided to maintain our minded-to position and not adjust SPN's allowance. Given that the work is being re-profiled, we do not consider it in consumers' interests to adjust the allowance downwards and risk further disruptive Link Box failures.

We expect the volumes of work to be delivered at the level proposed by SPMW as set out in their submission and by SPN as set out in the additional information provided by SPN, following our notice of proposed adjustment. We intend to review volume delivery as part of our RIIO-ED1 close out process.

The revised PCFM values for SPMW will be directed by 30 November 2018.

Yours faithfully,

SIGNED on 30 November 2017

Steven McMahon
Associate Partner, RIIO Networks

Annex A: Responses to consultation

In our consultation, we sought views on the questions set out below. A summary of the responses and our view is provided.

1. Do you agree with Ofgem's assessment and the proposed adjustment to SPMW's opening level of allowed expenditure for Link Box Costs?

We received two responses, from SP Energy Networks (SPEN) and Scottish and Southern Electricity Networks (SSEN), to the assessment and proposed adjustment to SPMW's opening level of allowed expenditure for Link Box Costs. Both responses were supportive of Ofgem's proposed adjustment. SSEN noted that the approach SPMW has taken in identifying the scale of the Link Box programme and subsequently Ofgem's assessment was reasonable. SSEN also noted that it expects Ofgem to closely monitor the delivery of the programme and make any necessary adjustments to SPMW's income levels as part of the RIIO-ED1 close out process. We intend to monitor the delivery of the programme and if required make any necessary adjustments through the RIIO-ED1 close out process. We will also report on the progress of the delivery of the Link Box programme for SPMW in the RIIO-ED1 annual reports.

Although SPEN support Ofgem's proposed adjustment to its opening level of allowed expenditure for Link Box Costs, it raised concerns on the exclusion of indirect costs from the scope of the Link Box reopener. Noting from previous experience, it designed the project team of 14.5 FTEs to deliver the Link Box replacements in RIIO-ED1 as it would not be possible to accommodate the additional workload among current staff. Ofgem do not consider indirect costs as part of the Link Box Costs as defined in the Regulatory Instruction and Guidance (RIGs), and referred to in CRC 3F of the licence and therefore disallowed these costs. However, we considered some of the indirect costs set out in SPMW's submission to be direct costs (specifically, the costs of two technical craft persons) and have allowed these costs. Additionally, SPEN noted that it was not convinced that the use of the upper-quartile unit cost is sufficient to balance the increase in costs. As noted in the consultation, it is our understanding that SPMW will use contractors to deliver the new Link Box programme. This competitive process is likely to drive down unit costs and provides further justification for us selecting the industry upper-quartile rather than industry median unit costs.

SPMW highlighted that the scale of the reduction (17%) made by Ofgem to the submitted costs will cause major challenges. However, it noted that it is in customers' interests that it puts all measures in place to effectively mitigate the risks associated with disruptive Link Box failures and therefore support our proposed adjustment.

2. Do you agree with Ofgem's assessment and the proposal not to make an adjustment to SPN's opening level of allowed expenditure for Link Box Costs?

We received three responses from SPEN, SSEN and UK Power Networks (UKPN), to the assessment and proposal not to adjust SPN's opening level of allowed expenditure for Link Box Costs. All responses supported our minded-to position not to make an adjustment. SSEN noted that SPN forecasting to replace an additional 8% of Link Boxes than what was set out in its original RIIO-ED1 allowance is positive for customers' network reliability. However, SSEN expect Ofgem to closely monitor the delivery of the programme and make any necessary adjustments to SPN's income levels as part of the RIIO-ED1 close out process. We intend to monitor the delivery of the programme and if required make any necessary adjustments through the RIIO-ED1 close out process. We will also report on the

progress on the delivery of the Link Box programme for all three UKPN licensees including SPN in the RIIO-ED1 annual reports.

UKPN supports Ofgem's decision not to make an adjustment, noting that it will allow it to efficiently mitigate the risk that Link Box failures present to the public.