

Steve McMahon
RIIO Networks, Electricity
Ofgem
Commonwealth House
32 Albion Street
GLASGOW
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31 May 2019

Dear Steve

Notice to the Authority under Charge Restriction Condition (CRC) 3F of the Distribution Licence: Eastern Power Networks plc's application to revise the opening levels of allowed expenditure in relation to Specified Street Works Costs.

In accordance with the requirements of Part A of CRC 3F of the Special Conditions of the Distribution Licence, Eastern Power Networks plc (herein known as EPN) serves notice that it proposes to revise the opening levels of allowed expenditure in relation to Specified Street Works Costs.

In line with the requirements of CRC 3F, please see below the information required under paragraph 3F.10:

(a) The uncertain cost activities to which the proposal relates

This notice relates to Specified Street Works Costs in the EPN region only.

(b) The changes to the licensee's allowed level of expenditure that is proposed and the Regulatory Years to which those changes relate

Supporting analysis can be found in the appendix to this letter but the proposed changes to allowances are summarised in the table below in £m 2012/13 prices.

2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	ED1 total
1.05	1.27	1.29	1.63	1.53	1.53	1.53	1.53	11.34

(Note: totals are correct to significant figures shown but do not match sum of individual years due to rounding)

(c) The basis of calculation for the changes to the licensee's allowed level of expenditure

The basis for the calculation of forecast values is explained in the appendix to this letter. Where possible, historic data from existing schemes is used to determine future costs in line with the approach taken for setting the ex-ante allowance for RIIO-ED1. Where necessary we have used assumptions and documented these in the annex to this Notice. In summary, the forecast is based on the following assumptions:

- Annual volumes for the remaining years of the RIIO-ED1 period will be equivalent to the volumes seen in the 2018/19 regulatory year. This represents the latest extent of coverage of applicable schemes in the EPN area and as such is the most representative year with respect to volumes for the remainder of the RIIO-ED1 period. This approach does not therefore involve making any future assumptions over volume increases.
- The unit cost for the remaining four years will be equivalent to the average unit cost seen to date in the RIIO-ED1 period. Given the extent of coverage in the EPN area taking an average of the annual unit costs observed to date makes full use of the available unit cost information, without seeking to make extrapolations into the future over the mix of costs likely to be incurred in the remainder of RIIO-ED1.

Further to the above, we can confirm that this proposal meets the following requirements outlined in CRC 3F.8:

(a) Is based on information about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when the licensee's Opening Base Revenue Allowance was derived

The requirements of the RIIO-ED1 business plan submission, as stated in the Strategy Decision¹, were that only costs associated with schemes for the DNO which had 12 months of data were considered for the ex-ante allowance setting. For schemes which this data was not available, the associated costs have been separately identified and reported in the annual RIGs submissions to Ofgem and we can confirm the values stated above are only in relation to these new schemes.

(b) Takes account of any relevant adjustments previously determined under this condition

No previous relevant adjustments have been made under this condition relating to Specified Street Work Costs for EPN.

(c) For all uncertain cost activities other than High Value Project Costs constitutes a material amount as specified for the licensee in Appendix 2, 3, 4 or 5 or (as the case may be) to this condition

The total actual and forecast cost relating to specified Street Work Costs in EPN, as shown in the table above, is £11.34m. This is greater than the material amount of £9.72m for EPN stated in Appendix 3 of CRC3F. All values are stated in 2012/13 prices.

(d) For High Value Project Costs passes the tests set out in Appendix 1

N/A.

(e) Relates to costs incurred or expected to be incurred after 1 April 2015

All costs reported in the Regulatory Reporting Pack submissions in RIIO-ED1 to date and summarised in the table above relate to costs incurred and expected to be incurred between 1 April 2015 and 31 March 2023.

(f) Constitutes an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of this licence

There are no other licence conditions which facilitate an adjustment to allowed expenditure for Specified Street Works Costs and the window between 1 May 2019 and 31 May 2019 is the only window provided under this condition.

The costs for the first three years of RIIO-ED1 summarised in the table above have been reported within the Regulatory Reporting Pack submissions and as such have been subject to an

¹ https://www.ofgem.gov.uk/sites/default/files/docs/2013/02/riioed1decuncertaintymechanisms_0.pdf

appropriate level of assurance as set out in our annual DAG submissions to Ofgem and covered in annual commentary in the RIGs. Costs for the 2018/19 reporting year also represent actual expenditure and are subject to assurance prior to being reported in the Regulatory Reporting Pack submission by 31 July 2019. Forecast costs for the years between 1 April 2019 and 31 March 2023 are provided on the basis described in the appendix to this letter.

We understand other DNOs may make proposals under the provisions of this condition that might require UK Power Networks to provide additional information or provide the current information in a different format for consistency. We welcome all further engagement to determine what further work is required in this area but request that this engagement is conducted promptly, with clear guidance and that sufficient time is given for all licensees to provide assured data in any revised format.

Persistent Organic Pollutants (in respect of all of UK Power Networks' licensees)

In addition to the Notice under CRC 3F we would like to take this opportunity to highlight another area of uncertain expenditure. The Persistent Organic Pollutants (POPs) regulations are in the process of being brought into European Legislation with the intention that they will be translated into UK Legislation. This will put a requirement on DNOs to ensure that all equipment with the potential to contain PCBs be replaced unless it can be positively proven to not contain them. Initial analysis shows that this has the potential to lead to significant additional costs that were not envisioned at the time of setting the RIIO-ED1 price control and were therefore not included in the RIIO-ED1 allowances. The currently predicted magnitude of these costs would mean that, as a programme, this work is very likely to meet the requirements of being classified as a High Value Project in many licence areas in Great Britain.

Although the initial indications are that there will be significant additional cost, there is still great uncertainty in this area due to the fact this requirement has only become clear very recently, and is still yet to be transcribed into law. DNOs, working with the Environment Agency are collectively working to find solutions to this issue that result in the most efficient approach that achieves the best outcome for customers.

For this reason, we would urge Ofgem to explore the following options to address the continued uncertainty:

1. Similar to the process undertaken in respect of the SHEPD subsea cable², the May 2019 re-opener window could be postponed until an appropriate time to re-assess the position when there is more certainty.
2. Ofgem to commit to making use of the HVP mechanism in the RIIO-ED1 closeout process to adjust allowances based on any material costs that arise through the efficient delivery of meeting this new legislative requirement. Requirements for reporting these costs should be explored as soon as possible to ensure they are captured in a suitable way to support the process at the end of the period.

We would welcome further discussion of the treatment of these costs associated with compliance with the POPs regulations in the RIIO-ED1 regulatory period and beyond.

If you have any questions on either of these areas in the meantime, please do not hesitate to get in touch.

² <https://www.ofgem.gov.uk/publications-and-updates/riio-ed1-decision-second-deferral-application-window-shepd-subsea-cables-costs-uncertainty-mechanism>

Yours sincerely

A handwritten signature in black ink, appearing to read 'James Hope', with a stylized flourish at the end.

James Hope
Head of Regulation
UK Power Networks

Copy Paul Measday, Regulatory Returns & Compliance Manager, UK Power Networks
Ross Thompson, Regulatory Performance Manager, UK Power Networks

Appendix – Analysis and assumptions

(Note: All costs in this appendix are stated in 2012/13 prices)

Street works schemes subject to re-opener

The table below shows a list of the schemes which were not included in the ex-ante allowances due to either not having 12 months of data available or not being in force at the time of setting allowances.

Reopener schemes	Type	DNO	Date established
East of England	Permit	EPN	05/11/2012
Buckinghamshire County Council	Permit	EPN	04/11/2013
Norfolk	Permit	EPN	06/05/2014
Essex	Permit	EPN	16/03/2015
Central Bedfordshire	Permit	EPN	01/04/2016
Cambridgeshire	Permit	EPN	03/10/2016
Thurrock	Permit	EPN	09/10/2017

Actual costs and volumes to date

These schemes have led to the following volumes of permits and associated costs in the first four years of RIIO-ED1 (note that figures for the 2018/19 year are subject to assurance ahead of Regulatory Reporting Pack submission by 31 July 2019).

	2015/16	2016/17	2017/18	2018/19	4 year totals
Volume	7,451	8,454	8,842	10,219	34,966
Cost (£m)	1.05	1.27	1.29	1.63	5.24
Unit Cost (£)	141.16	150.56	145.69	159.59	149.96

Forecasting assumptions

Volumes:

As new schemes have been introduced, the volume of permits within the scope of the re-opener have increased. There remains only one authority in the EPN region which has not yet introduced a permitting scheme. We have used the conservative assumption that the volume of permits will hold constant at 2018/19 levels for the remainder of the period.

Unit cost:

Average unit costs per permit have remained relatively constant over the period to date. Therefore, for the purposes of forecasting the remaining years cost, we have used the average unit cost of the first four years of the RIIO-ED1 period which equates to £149.96.

Forecast cost and volumes

Using the cost and volume assumptions stated above, we have calculated the forecast cost and volumes for the remaining years of the RIIO-ED1 period as detailed in the table below.

	2019/20	2020/21	2021/22	2022/23	4 year totals
Volume	10,219	10,219	10,219	10,219	40,877
Unit Cost (£)	149.25	149.25	149.25	149.25	149.25
Cost (£m)	1.53	1.53	1.53	1.53	6.10

(Note: totals are correct to significant figures shown but do not match sum of individual years due to rounding)

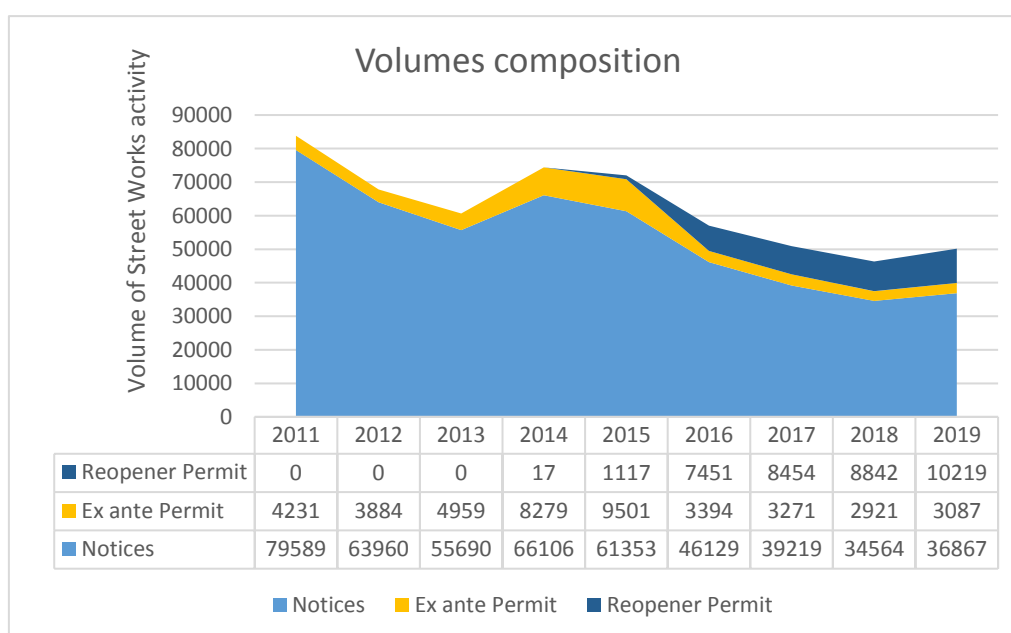
As can be seen from the two tables above, the total cost over the RIIO-ED1 period is expected to be £11.34m (£5.24m actual, £6.10m forecast) which is in excess of the materiality threshold for the EPN region which is set at £9.72m.

Exclusions stated in RIIO-ED1 Strategy Decision

The Strategy Decision stated the intent of the uncertainty mechanism and detailed that the mechanism was not intended to cover the following two areas:

Volumes of activity (except for load-related expenditure and new connections), i.e. the number of works

The chart below shows volumes of street works related activity and its composition in terms of the applicable legislation. As can be seen from the chart, although there has been an increase in work that is subject to permitting, there is no general increase in the overall volume of work over time.



The proportion of notices or permits that are subject to penalties

The chart below shows the proportion of permits that have been subject to penalties or overstay fines. The chart shows that there has been a significant (61 per cent DPCR5 average to current RIIO-ED1 average) reduction in the proportion of permits that have been subject to a penalty due to improved internal systems and processes and management focus.

