

**To: Electricity North West Ltd
Northern Powergrid (Northeast) Ltd
Northern Powergrid (Yorkshire) plc
London Power Networks plc
South Eastern Power Networks plc
Eastern Power Networks plc
SP Distribution plc
SP Manweb plc
Scottish Hydro Electric Power Distribution plc
Southern Electric Power Distribution plc
Western Power Distribution (West Midlands) plc
Western Power Distribution (East Midlands) plc
Western Power Distribution (South Wales) plc
Western Power Distribution (South West) plc**

Direction under Part C of Charge Restriction Condition (CRC) 2G (the Losses Discretionary Reward) to modify the Losses Discretionary Reward Guidance Document.

Each of the companies to whom this document is addressed is the holder of an electricity distribution licence granted or treated as granted under section 6(1)(c) of the Electricity Act 1989 (the Act).

In accordance with Part C of CRC 2G (the Losses Discretionary Reward) the Authority¹ gave notice on 15 August 2019 (“the Notice”) to consult on proposed changes to the Losses Discretionary Reward (“LDR”) Guidance Document². The Notice set out the reasons for the proposed changes and required any representations to be made on or before 12 September 2019.

Prior to the close of the consultation period in respect of the Notice, we received four responses. Three responses have been published on our website. The fourth response was supportive of the proposed modifications and notes a typographical error within the guidance.

We have carefully considered all representations received and Annex 1 sets out our responses and the further amendments we have made.

In accordance with Part C of CRC 2G, we hereby issue the modified LDR Guidance Document as contained in Annex 2. This decision will take effect on and from 26 September 2019.

This document constitutes a direction issued by the Authority under paragraph 2G.11 of CRC 2G and notice under section 49A of the Act.

¹ The terms “we”, “us”, “Ofgem” and “the Authority” are used interchangeably in this letter. The Authority is the Gas and Electricity Markets Authority. Ofgem is the Office of the Authority.

² <https://www.ofgem.gov.uk/publications-and-updates/notice-proposing-modifications-losses-discretionary-reward-guidance-document>

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Steve McMahon
Deputy Director, Electricity Distribution & Cross Sector Policy
Duly authorised on behalf of the Authority
26 September 2019

Annex 1 – Responses to the representations received and further amendments

We had four responses to the consultation, one of which raised no issues other than a typographical error. A summary of the responses and our views are noted below.

Weightings and reward allocation

- One respondent requested that the reward given to DNO groups should be spread by the number of customers in each DNO in that group such that customers are paying the same amount whichever licensee in a group they are connected to.

We note this view, however we do not consider it appropriate to make changes to the reward allocation at this time as we consider that a consistent approach should be taken throughout the incentive. We have therefore decided to retain the allocation as per tranche 1 and 2.

- The same respondent also asked for clarification as to when Ofgem will invite arguments for amending the weightings for each criteria (as set out in 5.1 of the guidance)

5.1 of the draft guidance stated that we would consider any arguments proposed for amending the weightings based on their merits. Given the responses from the consultation show there were no objections, and in one case support, for the weightings proposed, we have decided to make our decision now. The weighting for each criterion will therefore be as set out in Table 2. Paragraph 5.1 has been amended to reflect this decision.

- The respondent also questioned the wording in paragraph 5.10, which suggests that the assessment process and allocation of the reward pot between groups may change for tranche 3. Having considered this, we have decided that the assessment process and allocation of the reward will remain unchanged from tranche 1 and 2. The reason for this is to maintain consistency, as noted in a previous point.

Criteria

- One respondent questioned whether details of progress made by DNO groups in understanding losses and how this understanding has developed since tranche two should also be inclusive of progress made since tranche one. Under criterion (a), DNO groups are being assessed on how they developed an understanding of losses since the previous tranche. However, we consider how learning from tranches 1 and 2 have been applied under criteria b and c. Therefore we consider that there is no need to make a change as other criteria assess progress made since the start of the price control.

- One respondent questioned whether the criteria set out in 4.4(c) on progress to manage losses and proposals for RIIO-ED2 should be split into two criteria. We note this, however we have decided to retain to ensure consistency with the previous tranches as this will allow us to assess DNO group's performance across individual criteria throughout the incentive period.
- One respondent asked for clarity on what Ofgem means and expects with regards to the section of the criteria on proposals for RIIO-ED2. We are of the view that this is sufficiently clear and have decided not to amend.
- One respondent asked us to consider whether it is necessary to meet all the criteria to be eligible for a reward. They noted that DNO's individual initiatives can provide industry benefit without meeting all criteria and that the LDR contributes to continued investment in this area by the companies. Whilst we recognise the point made, the criteria set out the minimum level we expect from licensees applying for a reward. Whilst action in other areas is welcome, we expect DNO groups to perform strongly against all criteria. We therefore do not consider it appropriate to make changes.

Additional

- One respondent noted that the day of the submission deadline for tranche 3, 29th February 2020, is on a Saturday and proposed to extend this to the end of the next working day (2nd March 2020). We agree with this suggested change and have updated the guidance to reflect.
- The respondent also asked us to state whether the final submission date for Ofgem to request further information, to clarify points in the submission, would be the start or end of April. We note that the timeline shows that the period between the submission deadline and submissions being published is eight to ten weeks. As such, this indicates that the deadline for points of clarification is the end of April 2020. We have updated the guidance to provide clarity.
- One respondent asked for clarification on when Ofgem would make the final decision on rewards. Whilst the timeline indicates that the assessment period would be ten to twelve weeks, taking us to the end of July 2020, we do not, as with tranche 1 and 2, propose to set an exact date. We expect to publish a decision in summer 2020.
- One respondent welcomed the additional pages allowed for the main document to be submitted to us, but did not believe that the reduction in pages for the appendix was warranted. The respondent asked for clarification as to why the page limits changed. We note that the reason for the change was based on feedback from DNO groups. DNO groups indicated that it was difficult to provide sufficient evidence within the previous limit. We understand the concerns expressed but DNOs should only provide information that is directly relevant to their submission and they should be able to do this within the overall page limit.

- One respondent advised that additional guidance on the level of evidence required would assist the development of DNO submissions. Whilst we note this point, we want to avoid being too prescriptive in setting out the level of evidence required. We also emphasise that it is the responsibility of the DNO group to justify to us as to why they qualify for a reward. For this reason we consider that we have provided sufficient levels of guidance.
- One respondent welcomed the inclusion of supplementary questions to clarify aspects of the submission as well as supporting revised guidance for DNOs for DNOs to create proposals for how losses incentives should be managed in RIIO-ED2.
- A few respondents noted some housekeeping errors. These have been addressed where appropriate:
 - Section 3.7. “potential for awards” has been amended to “potential for rewards”.
 - Section 3.10. “in the DNO groups submission” has been amended to “in a DNO group’s submission”
 - 5.11. Removed this paragraph as this no longer applies.
 - Table 2, typographical error – this should read tranche 3 rather than tranche 2.
- A minor amendment has been made to paragraph 3.7 to make clear that it is the appendix of the decision that states where each of the DNO groups fell short in tranche 2.

Annex 2 – Losses Discretionary Reward Guidance Document

The Losses Discretionary Reward (LDR) Guidance Document is available on the Authority's website at:

<https://www.ofgem.gov.uk/publications-and-updates/direction-make-modifications-losses-discretionary-reward-guidance-document-0>