

RIIO-ED2 Informal Licence Drafting Consultation response

Annex 3: Outstanding policy challenges with
licence drafting interaction

October 2022



1 Introduction

This document is designed to be complementary to our informal licence drafting consultation response.

As set out in our covering letter, we have limited our comments and observations in the issues logs and detailed supporting annexes to those related to the drafting and workability of the licence and Associated Documents based on the current stated policy intent. We have deliberately not commented in issues logs where the policy is outstanding in terms of decision for ED2 or where we maintain that it is incorrect/ not optimal for ED2.

However, it is important that Ofgem do not misinterpret this as a change in view from ENWL. Our responses to all RIIO-ED2 consultations remain with the response to the Draft Determinations being the most recent.

We feel it is important to reiterate and highlight the key policy challenges remaining as we see it where they directly relate to a licence condition as sufficiently robust and detailed policy is a precursor to successful licence drafting. Where they do not relate to a licence condition we have not included these however our thinking and constructive policy and practical input to Ofgem remains unchanged, for example required changes to cost assessment, financing policies and disallowed programmes in Draft Determinations (DD) such as LineSIGHT safety proposal. It is critical that Ofgem consider or reconsider the representations we have already made in responses to previous RIIO-ED2 documentation where questions of policy have been raised or responded to both directly or indirectly. We remain keen to support licence drafting to implement developments to Ofgem policy thinking, including making drafting proposals and/or feeding back agilely to Ofgem as requested.

For clarity, transparency and ease of consideration we have set out in section 2 below the broad topic area, the licence condition(s) it relates to by reference to this published informal version of the licence for ED2, and a short summary of the policy challenge and position we maintain needs to be adopted for ED2. Detail and full evidence is not repeated here nor is the list exhaustive and as such our responses to RIIO-ED2 consultations to date are more important for Ofgem to refer to here.

2 Key policy areas

Policy area and licence reference	Policy challenge and summary ENWL position (<i>in bold</i>)
<p>Recovered revenue must equal allowed revenue</p> <p>(SpC 2.1)</p>	<p>The policy change from ED1 to ED2 places an unreasonable and unachievable obligation on DNOs when collecting revenue. By moving away from “reasonable endeavours” to “best endeavours” Ofgem is increasing the obligation on DNOs to achieve parity between recovered and allowed revenue. In a period of uncertainty and increased forecasting challenges this is not achievable and without due consideration of practical issues facing the DNOs. This may for example require multiple derogation requests to Ofgem to re-open and reset prices.</p> <p>Revert policy back to “Reasonable endeavours”.</p>
<p>Return Adjustment Mechanism</p> <p>(SpC 2.3)</p>	<p>We do not see how it can be justified to base the RAMs assessment on an incomplete view of equity returns. Equity returns have to fund the shortfalls from financing and tax and it therefore seems logical and essential for the legitimacy of the RAM for these to be included. Where licensees are overfunded for debt costs, which would include the net impact after inflation, the amount that they are charging customers represents an additional return and should be included within RAM. Further this should be on an actual company basis, rather than on a notional company basis.</p> <p>It is not unfeasible for a network that is performing poorly operationally to be granted additional effective subsidisation from customers, while also being overfunded in respect of its debt costs. This cannot be in the interests of customers and creates perverse incentives.</p> <p>Policy for RAMs should be to adjust equity returns post-financing and tax considerations.</p>

Policy area and licence reference	Policy challenge and summary ENWL position (<i>in bold</i>)
<p>Uncertainty Mechanisms</p> <p>Re-opener common parameters</p> <p>(SpC 3.2 & 3.6)</p>	<p>We strongly disagree with the proposal of a common materiality threshold of 1%. It is unclear, and unjustified as to why a different materiality threshold is being applied for ED as there is for GD2/T2. There is better justification for ED2 materiality being lower than in RII0-2, as the UM package for ED2 is more legislative and compliance based in its driver than for GD2/T2.</p> <p>Policy should be that the materiality threshold is no more than 0.5 percent (as a minimum) and zero for compliance-based re-openers.</p> <p>The ED2 framework continues to have a gap to deal with the indirect costs associated with re-openers. This should be resolved by the inclusion of indirects within re-openers, or preferably, via a specific mechanism such as an indirect scalar or escalator such as is present for T2.</p> <p>New mechanism should be included to cater for additional indirect costs associated with Uncertainty Mechanisms.</p> <p>We do not agree that there should be any UMs that are Authority only triggered.</p> <p>Revise the Net Zero re-opener to be both company and Authority trigger.</p>
<p>Uncertainty Mechanisms</p> <p>Re-opener – Environmental</p> <p>(SpC 3.2 part E)</p>	<p>Policy issues remain with the proposed Environmental re-opener. Whilst we welcome some changes made since DD, we continue to hold the view that a materiality threshold in these circumstances is an unnecessary requirement for such a compliance-based activity.</p> <p>We note the absence of the guidance document for this re-opener and welcome the wholesale review Ofgem are undertaking to make this workable for ED2.</p> <p>Change to a zero-materiality threshold in line with other compliance-based UMs</p>

Policy area and licence reference	Policy challenge and summary ENWL position (<i>in bold</i>)
<p>Uncertainty Mechanisms – Re-opener – Cyber Resilience (SpC 3.2 parts G and H, SpC 3.3)</p>	<p>We have previously shared our views on the appropriateness of re-opener windows for cyber and these have not changed.</p> <p>First re-opener window should be January 2024.</p> <p>We also disagree with the Cyber OT allowances being subject to a use it or lose it adjustment (UIOLI) as well as a PCD assessment. This is disproportionate and the use of two regulatory mechanisms for one activity creates unnecessary complexity and regulatory burden for no consumer benefit.</p> <p>UIOLI should be removed from this area of expenditure.</p> <p>In our materials issue annex we share our views on the appropriateness of the standard PCD assessment process for an area such as cyber and suggest that this is duly considered.</p> <p>Combine all cyber licence conditions into one area, considering the unique nature and tailor PCD assessment accordingly.</p>
<p>Uncertainty Mechanisms Re-opener – Digitalisation (SpC 3.2 part I)</p>	<p>We disagree with the policy to include a materiality threshold for this re-opener and that a single window only is included.</p> <p>The rapidly changing data and digitalisation landscape requires DNOs to be more responsive. As most of changes that would trigger the Digitalisation re-opener are driven by government or regulatory change, then we consider that this re-opener should have a zero-materiality threshold in line with other re-openers which are outside of DNO control and compliance driven in nature. By way of examples changes driven by Ofgem Significant Code Reviews such as Market-wide Half-Hourly Settlement (MHHS), or by revision to the Ofgem Data Best Practice (DBP) and Digitalisation Strategy and Action Plan (DSAP) guidance. To limit necessary data and digitalisation improvements by adding a materiality threshold and a single window risks limitation of consumer and wider whole system benefit which we do not think is the intent of Ofgem.</p> <p>Remove materiality threshold by setting it as zero for this re-opener and including re-opener windows in January 2025 and January 2027.</p>

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<p>Uncertainty Mechanisms</p> <p>Re-opener – Storm Arwen</p> <p>(SpC 3.2-part J)</p>	<p>On more than one occasion Ofgem colleagues have stated that a materiality threshold for this re-opener should not apply, however as yet this has not been changed within the licence condition. We remain of the view, as set out in our DD response, that a materiality threshold is not appropriate for this re-opener given its nature.</p> <p>We also propose that there is a second window in January 2026.</p> <p>Remove materiality threshold by setting it as zero for this re-opener.</p> <p>Add second application window in January 2026.</p>
<p>Uncertainty Mechanisms</p> <p>Re-opener – Wayleaves and Diversions</p> <p>(SpC3.2 – part M)</p>	<p>We welcome this new addition to the UM toolkit and note that this is evolving policy reflecting Ofgem consideration of responses to the DD.</p> <p>Given that the driver for wayleaves and diversions cost is external, and Government are considering policy changes¹, we consider it appropriate that this particular UM has a zero-materiality threshold.</p> <p>Remove materiality threshold by setting it as zero for this re-opener.</p>

¹ [Land rights and consents for electricity network infrastructure: call for evidence - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/land-rights-and-consents-for-electricity-network-infrastructure-call-for-evidence)

Policy area and licence reference	Policy challenge and summary ENWL position (<i>in bold</i>)
<p>Load Related Expenditure (LRE) conditions and mechanisms</p> <p>(SpC 3.2, 3.9 and 3.11)</p>	<p>We have maintained our support for fast acting and agile UMs for LRE and continue to support this aim. We shared our concerns in our DD response that the package of UMs risked delivery against these aims, and there are still a number of areas to be resolved within licence drafting.</p> <p>Whilst we support a mechanistic volume driver, we continue to be concerned that the implementation of metrics and indicators, as they are planned to be used, changes what should be a simple and mechanistic UM into a complex process, risks becoming unwieldy and outweighs the benefits that an automatic mechanism brings.</p> <p>Utilise the indicators within regulatory reporting, with no direct link to the UMs, or alternatively trial the metrics during the first part of the period.</p> <p>LRE UMs come with associated indirect costs which need to be catered for within the framework.</p> <p>New mechanism should be included to cater for additional indirect costs associated with Uncertainty Mechanisms.</p> <p>Further detailed work is required on unit rates for volume driver to ensure they adequately reflect the work required.</p> <p>Costs associated with procurement of flexibility services need to be adequately covered within the suite of UMs.</p> <p>Ofgem Final Determination to clearly state how these are expected to be factored into the suite of UMs.</p>
<p>High Value Project (HVP)</p> <p>(SpC 3.2 part L)</p>	<p>Whilst we agree with the principle of a “<i>high value</i>” threshold, we consider that the value of £25m proposed is too high for application in ED. Setting a threshold too high may result in projects needing to wait until ED3 which may not be in customers interest.</p> <p>Definition of HVP should have a threshold of £18m.</p> <p>We propose that a second window is set for January 2027 to align with the outcome of T2 Final Determinations and any projects that may arise from that process.</p> <p>Include second re-opener window for January 2027.</p>

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Price Control Deliverables (PCD) (SpC 3.3)	<p>The only common PCD in the ED2 framework is for Cyber which is a distinct and complex cost category.</p> <p>We note through licence drafting that the Net Zero re-opener and LRE re-opener provides for the creation of PCDs. We do not agree that this automatic creation of a PCD by default is appropriate as each situation will be unique.</p> <p>We therefore consider that PCDs should be added into the ED2 licence via Section 11A modification of the Act. This ensures that careful thought as to the most appropriate regulatory treatment is undertaken, via an open and transparent process. We believe that having such a default position may result in inappropriate PCDs being set purely driven by licence drafting.</p> <p>PCD should only be added via a re-opener under S11A modification.</p>
Undergrounding for Visual Amenity (UVA) (SpC 3.4)	<p>We continue to support the inclusion of this UIOLI and its continuation from ED1. However, we fundamentally disagree with the policy decision with regards to its cost assessment treatment. The inclusion of UVA within the disaggregated benchmarking is an error as it should exclude the category from application of ongoing and catch up efficiencies. This is an error as this UIOLI is based on customer WTP values for a sector allowance. Current policy treatment means it catches reductions based on the overall cost assessment outcomes.</p> <p>Revert to the ED1 cost assessment process and treat this category completely separately as a bolt-on UIOLI allowance.</p>
Uncertainty Mechanisms – PCB volume driver (SpC 3.5)	<p>We fundamentally disagree with the policy to include a sunset clause within the licence provisions for this area. There are several examples of compliance dates changing as well as practical considerations where PCB activity will occur beyond the current compliance deadline for example changes in assessment of asset types within the modelling, issues relating to supply and the ability to source the relevant equipment needed. Including a sunset clause with no mechanism for funding beyond the date gives no regard to these legitimate practical considerations where policy makers are already reviewing the existing legislation which will have delivery considerations for DNOs.</p> <p>Remove the sunset clause policy for ED2 and include provisions for funding legitimate and relevant activity beyond this date.</p>

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<p>Uncertainty Mechanisms</p> <p>Re-opener and PCD - Net Zero</p> <p>(SpC 3.6)</p>	<p>The scope needs to reflect the practicalities, realities and differences in framework for ED when compared to GD/T. For example, changes arising from LAEPs are likely to go through the Load re-opener mechanisms.</p> <p>Further, all the Net Zero Developments are outside of DNO control it is therefore imperative that the materiality threshold for this re-opener should be zero.</p> <p>Additionally, but notwithstanding that Net Zero Developments are outside of DNO control, we disagree that this should be authority only triggered. It is more than likely that DNOs will have greater insight and foresight than Ofgem into events which will require the application of Net Zero re-opener as defined in the scope.</p> <p>Finally, as raised in the PCD section of this document, a modification via re-opener should not automatically result in the creation of a new PCD as the potential breadth of this re-opener means that it is not possible to know with any degree of confidence whether a PCD is the right regulatory tool to use. As a result Ofgem risks tying itself into unworkable PCD's.</p> <p>Various remediations are needed (see our DD response and working group interactions for more details).</p>
<p>Interruptions Incentive Scheme (IIS)</p> <p>(SpC 4.4)</p>	<p>Incentives are a key part of the RIIO framework and thus we do not agree with the asymmetry in Cap and Collars as proposed. This artificially restricts improvements that customers have indicated that they want and are willing to pay for as well as exposing the DNO to risk from the asymmetric incentive design that is it not rewarded for managing.</p> <p>Revert policy to symmetrical cap and collar for IIS.</p>
<p>DSO incentive</p> <p>(SpC 4.8)</p>	<p>In our DD response we proposed a greater balance between the three incentive components and an alternative weighting.</p> <p>Revise weighting of the components.</p>

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<p>Dig, fix and go output delivery incentive (DFG)</p> <p>(SpC 4.9)</p>	<p>We fundamentally disagree with the policy to halve the proposed incentive rate for this stakeholder led bespoke ODI-F. By justifying the reduction in incentive rate by “we are proposing to accept for UKPN’s collaborative street works ODI” noting they “share similar benefits” this provides proof that Ofgem has missed the vital differences between the two proposals which justifies the difference in incentive rate.</p> <p>We acknowledge the types of benefit are similar, however we disagree that the scale of the benefits is similar. We can detect the main difference through our own experiences – planned street works can be scheduled in such a way as to minimise disruption and are known in advance, whereas emergency street works are in response to unexpected issues and therefore by their unplanned nature cause more disruption. The differences in the two proposals are notably, but not limited to, the types of work seeking to be improved for customers and volume of the activity to be undertaken as well as the nature of activities i.e. difference in benefits realised between planned and unplanned activities.</p> <p>Increase the incentive rate for DFG to reflect differences between incentive proposals and benefits to be realised for customers.</p>
<p>Pass-through costs</p> <p>(SpC 6.1)</p>	<p>The policy for pass-through costs must include code fees not just Ofgem licence fee and DCC costs. As set out in our ED2 publications costs related to codes for example REC, DCUSA etc are irrefutable and need to be included within pass-through.</p> <p>Include all codes fees in pass-through.</p>
<p>Removal of licence condition - Smart Meter to a volume driver</p>	<p>We disagree with the policy to remove the Smart Meter volume driver for ED2. This is because there remains continued uncertainty over the smart metering rollout in our area. This uncertainty also includes the continuing issues with smart metering-related communications in our area.</p> <p>Revert treatment of Smart Meter to a volume driver as per ED1.</p>