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27 October 2022

Sent by Email: Joanna.gaches@ofgem.gov.uk
Cc: Steve.mcmahon@ofgem.gov.uk

Dear Joanna,

RIIO-ED2 Informal Licence Drafting Consultation

ENWL welcomes the opportunity to informally review and respond to the current working version of the licence for the RIIO-ED2 period. We have engaged extensively with Ofgem and others through the Licence Drafting Working Group (LDWG) since its inception and will continue to between now and the Licence coming into force at the start of ED2 subject to any further processes.

By its nature not all licence and associated matters are fully documented. None the less it is a useful step in the process. However, it is important to specifically state now that in coming to a view regarding accepting the price control we will need to be provided with clarity from Ofgem on any and all material issues. What this means as a minimum is an accurate licence, full suite of completed Associated Documents, PCFM (including guidance) and Financial Handbook that enable us to fully understand the implications of the ED2 price control, including any close out processes.

We have, as requested, endeavoured to make our comments in issues log format. To support transparency and ease of implementation of issues contained in the issues logs we have provided more detailed appendices where more substantive comments are necessary. Where we have done so the issues log will clearly state this to be the case.

For clarity we have sought to provide comment on the drafting and whether it works in practice with key policy feedback provided in a separate annex to our response to the informal licence consultation. The policy feedback at this stage is focussed on readily available solutions or suggested ways forward. The annex of policy feedback sets out more detail as may be necessary for either; live and ongoing policy development by Ofgem, new policy issues that have arisen since Draft Determination (DD) that have come to light as part of putting the detail in the licence, or where policy in DD was high-level and further detail through licence drafting is in question.



Our response is comprised of 5 annexes namely; Annex 1 covering our response to the high level consultation questions posed, Annex 2 a supporting document for material issues identified in issues logs and set out in this letter, Annex 3 areas of outstanding policy challenges with licence drafting interaction, Annex 4 the Issues logs for licence conditions, and Annex 5 ENWL issues relating to defined terms.

We are providing feedback on Ofgem Annex 5 (legacy PCFM) and Annex 6 (legacy Revenue RIG) directly to the Ofgem representatives on the ED2 financial model working group. A long-established process via the Gitlab platform collates any issues or questions with the financial models as they have developed. As requested, we have also used these two legacy models to provide Ofgem with our latest ED1 forecast position.

This provision of documentation by Ofgem within the consultation is incomplete and when coupled with a 4-week consultation period will unambiguously lead to a sub-optimal informal consultation process. DNOs as a collective through the ENA have sought to provide detailed workable solutions to Ofgem throughout the process up to informal consultation though it is disappointing to see limited response to these from Ofgem with little remediation to issues reflected in the current drafting (for example Treating Customers Fairly, Best Versus Reasonable Endeavours and the licence mechanisms for Cyber IT and OT).

The process has meant DNOs have only seen completed issues logs with Ofgem responses at this point with little information from Ofgem on reasoning in some areas. Concerns that sufficient process has been undertaken remains (though we note that policy has taken longer to come through in some areas). We urge Ofgem to continue to engage with DNOs to achieve the objective of a complete and workable licence for all parties and start the formal consultation¹ earlier if possible and to allow extra time for stakeholders to respond given the current plan is to run this important consultation in a short period over Christmas and New Year.

We do note that the informal licence consultation reflects Ofgem decisions made in Sector Specific Methodology Decision and positions set out in the DD more broadly. It is welcome that in some limited cases it also reflects evolving policy which has been informed by DNO and other stakeholders response to the DD and ongoing working group meetings. However, there are a substantial amount of areas where we consider the policy not to be the right choice in consumers interests, so therefore disagree with the policy positions, or where the policy is incomplete. In our DD response, via working groups and bilateral engagement, we have provided compelling evidence and reasoning as to why policy should change. Our comments on licence drafting, where we have sought to constructively input to drafting led by Ofgem to implement its policy choices, does not imply, our agreement with Ofgem policy choices.

To that end we expect that significant changes to this version of the licence will need to occur between the close of this consultation and the start of the formal statutory consultation in December and looking further ahead the start of RIIO-ED2. These changes will need to reflect decisions made as part of the Final Determinations (FD) at the end of November, as well as gaps in the current licence draft and policy evolution required for a workable licence in RIIO-ED2 that implements policy choices more strongly in consumers interests. With only one LDWG scheduled in this period to the start of ED2 we urge Ofgem to consider if more working group time is needed along with earlier sharing of proposed conditions and guidance. To that end, we remain open to working with Ofgem and other DNOs to support this process should more time be scheduled.

Having fully reviewed all the available material at this stage we have below set out our top 5 concerns, which have been developed collectively through the Energy Networks Association (ENA) with the published licence drafting and a short summary of what is necessary to remediate the concerns. For clarity we have not undertaken a full proof read of spelling, grammar and punctuation. Where we have

¹ anticipated mid-December

noticed these we have flagged though it remains important Ofgem complete this at the end of the process.

1. Load Related uncertainty mechanisms

Expanded on in Annex 2 Section 5

The proposed licence includes a “toolkit” of uncertainty mechanisms that Ofgem plans to introduce to manage the uncertainty associated with load-related expenditure. These mechanisms need to be designed to operate correctly together to enable DNOs to be responsive to changing network demand.

Ofgem set out one of its objectives of these mechanisms as “ensuring the networks are not a blocker to net zero by having sufficient funding to invest in network capacity and that low carbon technologies do not face installation or operational delays”. As currently drafted, the conditions fail to achieve this effect. In contrast, the conditions introduce uncertainty about whether load related activities will be appropriately funded. The suite of conditions introduces unclear processes and a risk of unfunded obligations and double-counted adjustments. Further, it doesn’t enable consumers need to be met and risks stakeholders’ ambitions for growth, Net Zero and energy security (diversification and decentralisation) which are the wider fundamental issues.

Considerable work is required to achieve acceptably drafted conditions in this area. We have proposed the main changes that are required to achieve this.

The importance of getting these conditions right is further increased by the Ofgem proposal to only adjust baseline allowances for the outcome of the Access SCR for the first two years of RIIO-ED2. It is now very likely that all DNOs will trigger both the Load Related Expenditure Re-opener and the Net to Gross adjustment for Load Related Expenditure, and it is also possible that they will require the volume driver cap to be increased mid-period to reflect wider behavioural change resulting from the outcome of the Access SCR.

Furthermore, it is essential that ex-ante allowances are established in a manner that is consistent with the expected operation of the various uncertainty mechanisms. Any inconsistency between the way in which baseline allowances are set and the way in which the mechanisms are expected to operate may result in double counts or gaps in the allowances that are ultimately modified into the licence and practical challenges in RIIO-ED2 operating the LRE mechanisms. DNOs must be provided by Ofgem with detailed information under-pinning the assumptions made by Ofgem in setting allowances, in order for the re-opener to operate appropriately.

2. Licence gaps

Expanded on in Annex 2 section 2

This consultation on the proposed package of RIIO-ED2 licence conditions and Associated Documents is incomplete. The critical PCFM has not been shared as part of the consultation meaning that cross-referencing from licence to PCFM is not possible. There are several important chapters of the PCFH that are either missing or incomplete. These are needed to be able to understand and comment on the detailed implementation of the price control.

A number of Associated Documents are also not yet ready for consultation, and some licence conditions have yet to be shared. We recognise that, in some cases, this is due to policy not being sufficiently complete to support their inclusion. However, in some cases this is due to insufficient progress being made by Ofgem.

It is important that DNOs are able to view all parts of the licence and its Associated Documents together to be able to understand how the price control components will work together and have a clear and complete set of expectations and obligations. In particular, we note that there has been

no progress to date in developing the Regulatory Instructions and Guidance (the RIGs) that will be needed to ensure that all necessary data is captured from start of the RIIO-ED2 period.

Further, we note that work is ongoing to develop a mechanism to deal with increasing indirect costs where a re-opener is triggered. This is a key component of the uncertainty mechanisms that needs to be seen in order to ensure that the aim of agile and fast acting uncertainty mechanisms can be met.

3. Re-opener conditions

Expanded on in Annex 2 section 3

3a. Legal requirements:

We have concerns around the clarity of the re-opener conditions in the proposed licence and currently do not view it as consistent with the legal requirements of the Electricity Act 1989 (EA89).

The CMA confirmed that for any “self-modification” licence condition to be lawful, it must specify the time, manner and circumstances in or under which a modification can be made. If such criteria are correctly set out in the condition itself, the licensee in question should be able to understand the potential impact on it of a future modification at the outset of the price control simply by reference to the condition.

We have significant concerns that two aspects of the published drafting of re-opener conditions fail to meet these requirements and lead to it not being possible for licensees to understand the potential impact of a future modification on them:

- Without change or elaboration, we do not believe that the wording of the “evidence test” sufficiently specifies the circumstances under which a modification can be made.
- Several of the re-openers include provision for the Authority to “instigate the re-opener”. However, the conditions are silent on the process that the Authority would follow when instigating the re-opener and do not sufficiently specify the circumstances under which a modification can be made.

3b. Policy intent:

We have further significant concerns with the inappropriate way in which some of the re-openers operate. In particular:

- We have a number of concerns related to the application of materiality thresholds in uncertainty mechanisms:
 - Firstly, inconsistency in the wording used means that it is not always clear whether the materiality threshold is to be assessed relative to the amount of allowance that has previously been provided. This makes the scope of the re-opener unclear and may lead to some DNOs who may legitimately expect an allowance adjustment not being entitled to one.
 - Secondly, the definition of Materiality Threshold merits a more prominent location in the Licence, such as in an appendix to special condition 3.2.
 - And thirdly, Ofgem’s approach to deciding which re-openers have materiality thresholds before any adjustment is made and which do not is inconsistent with Ofgem’s verbal clarification that as a minimum those re-openers that relate to regulatory change/ compliance-related activities would not have a materiality threshold as licensees should not have to face financial exposure from mandatory requirements.

- In addition to our separate feedback regarding concerns with the various load-related and cyber uncertainty mechanisms, we believe that two further uncertainty mechanisms still require some policy work to ensure that the key definitions are updated to set the correct scope: Wayleaves and Diversions Re-opener and PCB Interventions volume driver. We have provided detailed drafting suggestions in the appendix to this letter.

4. Treating Customers Fairly licence condition and associated documentation needs changes to deliver the policy intent which we support

We fully support the intent of SLC10AA, which is to ensure domestic customers are treated fairly. We also agree with the policy intent explained by Ofgem during policy meetings, including the examples of specific scenarios that would not result in enforcement action.

We do remain concerned that the current drafting of the licence condition and the Fair Treatment Guidance does not fully align obligations with the policy intent and, therefore, leaves licensees exposed to unwarranted risks, including potential enforcement action. Specifically, the absolute obligations in the licence condition are drafted in such a way that could result in activities that DNOs routinely undertake breaching “the letter” of those obligations. As such, under any view the condition as drafted cannot be construed as a ‘principles-based’ licence condition, contrary to the stated policy intent of Ofgem.

Collectively, through the ENA, DNOs provided Ofgem with important and detailed drafting suggestions for both the licence condition² and the associated Fair Treatment Guidance³.

At the Licence Drafting Working Group (LDWG)⁴ Ofgem indicated agreement with a range of our proposed drafting suggestions and presented a further draft of the condition which implemented these. We had expected that further version of SLC10AA to be included in this consultation for stakeholder consideration. That is not the case, and the issues log does not explain why these changes have not been made. Some DNOs have requested copies of the version of the licence condition that Ofgem presented at that LDWG but, as at the time of writing, have had no response to this request.

We are disappointed that the version including those changes have not been consulted on now and, given that position, would question whether the licence condition and the accompanying Fair Treatment Guidance were ready for public consultation and suggest Ofgem might have usefully pointed out to all stakeholders the changes it has told DNO’s it will make.

To avoid duplication, we do not repeat our suggested drafting changes in our response to this consultation. We would emphasise that we believe those drafting changes to be appropriate and that it is essential that Ofgem considers the DNOs’ detailed proposals made in the two submissions and at the LDWG. The main issues that our drafting suggestions sought to resolve are further explained below:

4a. Licence condition (SLC10AA)

Our main concern with the licence condition remains the absolute phrasing of the condition could result in DNOs breaching “the letter” of those obligations simply by undertaking routine activities. We remain concerned that the Ofgem enforcement team may interpret the condition literally, leading to disproportionate and unnecessary levels of enforcement activity.

² sent to Ofgem on 15 September 2022

³ sent to Ofgem on 16 September 2022

⁴ on 22 September 2022

Ofgem has confirmed at policy meetings that the specific examples that concern us would not be expected to breach the requirements of the licence condition. Ofgem also expressed the view that a principles-based licence condition is not intended to stipulate definitive steps which must or must not be taken. Therefore, changes should be made to align the wording of the licence condition with the interpretation shared by Ofgem at policy meetings and to better reflect how Ofgem has described a principles-based licence condition would operate.

Most importantly, the licence condition must be drafted to make it clearer that failure to meet “the letter” of the Standards of Conduct does not constitute a breach of the licence condition provided that the DNO has complied with the requirements to act in a manner consistent with the Customer Objective and to deliver a Fair outcome for Domestic Customers.

We believe that there are a few different drafting approaches that could achieve this:

- place a “reasonable endeavours” obligation on the DNOs and make changes/qualification to those specific aspects of the Standards of Conduct that are of greatest concern to Ofgem⁵; or
- change the wording of paragraph 10AA.4 so that it is clear that the Standards of Conduct are not to be interpreted prescriptively, as long as paragraphs 10AA.2 and 10AA.3 have been complied with. By example this could be achieved by amending paragraph 10AA.4 to read: “The Standards of Conduct in the procedures and processes which the licensee must put in place are that the licensee and any Representative must: ...”. This would need to be accompanied by changes/qualification to those specific aspects of the Standards of Conduct that pose the biggest concern; or
- make detailed changes to the wording of all aspects of the Standards of Conduct so that all aspects are drafted in a way that “the letter” of each aspect could be readily met by DNOs when carrying out their routine activities.

4b. Treating Customers Fairly associated documentation (Fair Treatment Guidance)

The Fair Treatment Guidance currently adds very little to what is set out in the licence and does not provide any meaningful “guidance” to the licensee. Without meaningful guidance, and as the licence condition is currently drafted, it creates a real risk of hindsight regulation. It is widely acknowledged that hindsight regulation is not best practice and we urge Ofgem to avoid creating this regulatory environment.

Sections 2 and 3 of the Fair Treatment Guidance do not provide any guidance on the interpretation of the licence condition. They simply repeat or paraphrase aspects of the licence condition itself. Furthermore, the Fair Treatment Guidance seems to introduce a new concept of “customer outcome” which is not anticipated by the licence condition itself, is not included in the licence definitions and is, therefore, unclear. It is essential that the Fair Treatment Guidance is expanded considerably to provide guidance and actual examples.

Section 4 (How Ofgem applies the Standards of Conduct) does not fully align with the process that Ofgem has explained in policy meetings. It also introduces concepts of a “fairness test” and “compliance threshold” which are not explained. In particular, it is essential that this section is refined to clearly set out the tests and logic that Ofgem will apply in enforcing this licence condition and the Standards of Conduct, as outlined by Ofgem at the various policy discussions for this condition. The detailed drafting suggestions we provided previously will enable this to be achieved.

⁵ the approach proposed by DNOs on 15 September 2022

It is essential that amended versions of the licence condition and Fair Treatment Guidance are brought to the next LDWG, to allow further review prior to the Statutory Consultation.

5. Derogations

We believe that Ofgem should also take the opportunity afforded by the detailed review of the licence to build-in learning from COVID-19 in respect of derogations. Relevant licence conditions should have clauses built into them to enable them to be switched off on request of the licensee and consequent direction from Ofgem. An alternative solution to the clauses being added into each licence condition is to include an appropriate equivalent clause in special condition 1.3 (Common Procedure) and SLC2 (Interpretation of this licence).

We continue to support work towards an overall framework and settlement including financing aspects for RIIO-ED2 that enables the delivery of key objectives, whilst ensuring outcomes in customers interests are aligned with that of other stakeholders. This can be achieved by Ofgem though time is short to achieve this. Given that Associated Documents are still not published/ are incomplete and with only one more meeting until Statutory consultation, Ofgem should continue to carefully consider its forward plan. This should include its engagement with DNOs and wider stakeholders as well as considering or reconsidering the solutions and views it has received from all parties to date including those provided preceding this informal statutory consultation.

We have responded to the informal statutory consultation on the Licence focussing on the issues logs but we have provided summary responses to the common questions in Annex 1. As always, this response should also be read in light of our previous correspondence on RIIO-2 and RIIO-ED2. If you have any questions relating to our response, please don't hesitate to contact me or Paul Auckland (paul.auckland@enwl.co.uk).

Yours sincerely,



Paul Bircham
Engagement and Regulatory Strategy Director

Encs:

Annex 1: Response to Consultation Questions

Annex 2: Supporting document for material issues

Annex 3: Outstanding policy challenges with licence drafting interaction

Annex 4: Issues logs (various)

Annex 5: Definitions