



SSEN Distribution Response to ED2 Draft Determination - Annex 13: Licence Drafting



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We note that the licence drafting element of Ofgem's RIIO-ED2 Draft Determination is a progress update rather than a consultation. This is as expected, and we will continue to work with Ofgem at the Licence Drafting Working Group (LDWG) in advance of the licence drafting consultation in September. However, we would like to take the opportunity to reiterate some concerns with specific areas of the licence drafting, all of which have previously been raised jointly by the DNOs via the ENA as part of the ongoing licence drafting work. We note that this is not an exhaustive list, and we will of course respond in full to any future consultation on RIIO-ED2 licence drafting. We have also summarised these concerns in Appendix 1.

As a general point, we would highlight the significant amount of work required to ensure a full set of licence conditions, financial instruments and associated documents are sufficiently drafted to enable a meaningful consultation in September, particularly noting the limited opportunities to make material amendments to the drafting as part of the statutory consultation. We welcome Ofgem's intent to extend upcoming LDWGs to two days to assist in meeting the timescale, however we still consider this to be tight, particularly if significant issues are identified. To ensure that the LDWG can consider the licence conditions effectively, provide constructive commentary and/or drafting proposals and achieve the September deadline, policy issues must be resolved at the relevant working group prior to the licence condition being presented at LDWG. Consideration should also be given to when and how DNOs are given sight of licence conditions that Ofgem deems to be finalised; we note the majority of amendments suggested by DNOs are not included in the published licence conditions, even in examples where these were simple correction to formulae.

The Associated Documents will be key as this is where much of the detail for some licence conditions will be prescribed. We would request that the Associated Document for a licence condition is presented at the LDWG alongside the relevant licence condition, and our preference is for obligations to be clearly set out in the main licence and subject to a full licence modification process. This will ensure that a full review is possible, and any issues can be readily identified. We note that where this is not possible, full versions of the documents should be provided as part of the consultation and/ or Ofgem should consider separate consultation.

As noted in paragraph 10.130 of Ofgem's Finance Annex, the DNOs have raised concerns with Ofgem's proposal to require licensees to use best endeavours rather than reasonable endeavours in setting network charges to ensure that recovered revenue equals allowed revenue. Our concerns in this regard are that the use of 'best endeavours' may require DNOs to take significant additional steps in forecasting charges that may be disproportionately onerous or cut across other customer objectives. In addition, we are concerned that a DNO will always risk breaching this licence condition if the actual charge does not reflect the forecast, given a DNO is obligated to use best endeavours to forecast accurately. As Ofgem is aware, there are a number of significant necessary uncertainties when we set our tariffs, which are exacerbated by the requirement to set our tariffs 15 months in advance. The removal of the two-year lag further exacerbates this issue as we will be reliant on forecast for aspects such as incentives, pass through costs and uncertainty mechanisms.

We do not consider that Ofgem has sufficiently justified its change in approach from RIIO-ED1. We note Ofgem's comment that 'a DNO would do its best if it were to act as a prudent, determined and reasonable DNO acting properly in its own interests...'. Our view is that acting as a prudent and reasonable operator is an existing overarching requirement for DNOs, but that the use of 'best endeavours' places an additional burden on DNOs to undertake additional activities in forecasting tariff setting that may result in additional costs (ultimately to consumers). Ofgem has not recognised that the increasing costs would require to be funded by consumers nor that there are already existing protections in place to protect consumers from any deviation between allowed revenue and recovered revenue. Paragraph 10.129 of Ofgem's Finance Annex notes that "Whilst consistency is not a reason for best endeavours in and of itself, there should be a reason for inconsistency between sectors." We consider there to be clear reasons to justify a different approach for electricity distribution, including the

requirement to give 15 months' notice of changes to network charges and the additional forecasting complexities associated with that which will be compounded by the removal of the two-year lag. GDNs will have the required actual data at the time of setting network charges, whereas due to the differing obligation on DNOs, they are required to set charges on the basis of forecasts. Consequently, we are concerned that a DNO will always risk breaching this licence condition if the actual charge does not reflect the forecast, given a DNO is obligated to use best endeavours to forecast accurately.

Without prejudice to our position that the obligation should continue to be based on reasonable endeavours, if Ofgem ultimately disagrees with the DNOs and opts to introduce a best endeavours obligation, it must include a set of exhaustive guidance specifying the actions that DNOs should undertake to meet the standard. This guidance should either be set in the licence itself, or in guidance that has the appropriate power to qualify the obligation in the licence.

If Ofgem intends that a DNO that complies with the associated PCFH guidance will be deemed to have complied with the over-arching obligation this should be made clear on the face of the licence. (DD finance annex para 10.131) We note that the proposed PCFH guidance on forecasting Variable Values referred to by Ofgem is not yet available. It is essential that well-developed drafts of these obligations should be made available to DNOs as soon as possible so that they can consider how any new requirements will be implemented. Please also see our response to FQ36 on this matter.

Finally, we remain concerned with the new Treating Domestic Customers Fairly licence condition. We fully support the policy intent of this licence condition and the principle of treating domestic customers fairly. However, as currently drafted, this is not fit for purpose and could result in non-compliance for DNOs when carrying out normal day to day business activities. This is due to the licence condition being drafted in such a way as to place absolute obligations on DNOs to comply with very wide-ranging statements that do not allow for any reasonable deviation. An example is the requirement to 'provide information (whether in writing, orally, or visually) to each Domestic Customer with whom the licensee or any Representative interacts, which is complete, accurate and not misleading...' The provision of estimated supply restoration times to customers during a supply interruption is something that is valued by customers, however by its nature, this information is an estimate based on the best available information we have at that time.

A detailed joint DNO response has been sent to Ofgem on this issue, providing examples of several normal DNO activities that could result in non-compliance under the new licence condition. This also explains that there are existing regulatory measures in place to protect customers where DNOs fail to meet standards that customers would expect, including the Electricity (Connections Standards of Performance) Regulations 2015 and the Electricity (Standards of Performance) Regulations 2015 which require DNOs to compensate customers if they do not meet the required standards.

We caution that we cannot accept this licence condition as currently drafted for the reasons outlined above and in the joint DNO note on this issue. We welcome Ofgem's intent to hold a specific session to discuss this licence condition further and trust that the DNO concerns will be fully accounted for as part of this process.

We look forward to engaging proactively with Ofgem in the upcoming LDWGs to ensure that we work towards having a suitable set of licence conditions for consultation later in the year. Overall, we have found the LDWGs to be well organised with licence conditions provided in advance for DNOs to review. We will continue to work collectively with the other DNOs and provide joint notes on issues that affect us all; timely and detailed responses to specific issues raised in these joint notes will be essential to ensure that we are able to understand Ofgem's position and respond accordingly.

Appendix 1 – Summary of concerns

Issue	Summary of Concerns
<p>Process and timeline</p>	<ul style="list-style-type: none"> • Programme slippage • Limited opportunity to work with Ofgem to resolve issues in advance of consultation • Licence conditions taken to LDWG with outstanding policy issues • Lack of visibility of key associated documents
<p>Use of “best” endeavours for tariff setting</p>	<ul style="list-style-type: none"> • Requires DNOs to take significant additional steps that may be disproportionately onerous and cut across other customer objectives • Risk of licence breach if forecasting is not accurate • Above risk inappropriate given that DNOs must set tariffs 15 months in advance with necessary uncertainties • Removal of two-year lag exacerbates the uncertainty
<p>Treating domestic customers fairly</p>	<ul style="list-style-type: none"> • Could result in non-compliance for DNOs when carrying out normal business activities • Wide ranging statement with absolute obligations • Cuts across other obligations