

ET SECTOR	
REFERENCE NUMBER:	CATEGORY: Amendment
LICENCE CONDITION NUMBER: <i>(if relevant):</i>	SpC 7.8
TITLE:	Close out of the RIIO-1 adjustment in respect of the Environmental Discretionary Reward Scheme
RELEVANT LICENCE CONSULTATION QUESTIONS <i>(if any):</i>	
RELEVANT ISSUES LOG:	EDR Close Out Issues Log – September No 16
POLICY ISSUES	Completed by: Julie Hooper, Chris Warburton
<ul style="list-style-type: none"> SpC 7.8.4 SpC 7.8.5 	<ul style="list-style-type: none"> On SpC 7.8.4: <ul style="list-style-type: none"> There is no formula included in this licence condition. We propose that the formula should be cross-referenced to the T1 licence as in other close out conditions, with any changes required set out in the T2 licence conditions. The response from Ofgem to an issue raised in previous log stated that the formula is not required as the ‘average specified rate’, which is in the T1 licence calculation, will be applied at a global level in RIIO-T2. However, how ‘average specified rate’ will be treated is not clear and this should be clarified and set out within the licence drafting. On SpC 7.8.5: <ul style="list-style-type: none"> We do not agree that the licence condition should cease to have effect from 1 April 2022. This is inconsistent with other close out licence conditions. If the intention is to make clear that there will be no EDR direction following the first year(s) of RIIO-T2, we suggest “For Regulatory Years commencing on or after [1 April 2023], the value of LEDR_t is equal to zero”. The current drafting causes an issue with SpC 7.1.2, which continues to refer to SpC 7.8 for the entire period. In any case, we consider that Ofgem should retain the two year lag on this incentive, to be consistent with other incentives.

DRAFTING ISSUES	
<ul style="list-style-type: none"> • General • SpC 7.8.2 • Definitions 	<ul style="list-style-type: none"> • It appears to us that there should be a provision to make clear that, in the absence of a direction, LEDR_t has a value equal to zero. • SpC 7.8.2 states <i>‘The effect of the condition is to close out the RIIO-ET1 Environmental Discretionary Reward Scheme’</i>. This does not include reference to the affected years which is included in other comparable licence conditions. We suggest adding “...such that revenue in the [Regulatory Years commencing on 1 April 2021 and 1 April 2022 reflect] the licensee’s performance under that incentive in Regulatory Years commencing on 1 April 2019 and on 1 April 2020” (noting, as raised elsewhere that the definition of Regulatory Years needs to be updated to allow it to cover these years). • We suggest that the defined term should refer to the incentive being closed out, rather than the scheme. This is consistent with other close out licence conditions. We suggest <i>“RIIO-ET1 Adjustment in Respect of the Environmental Discretionary Reward Scheme”</i>.
FINANCE ISSUES	
<ul style="list-style-type: none"> • General 	<ul style="list-style-type: none"> • The values per the T1 calculations are in nominal price base (using RPI). It is not clear from the drafting how Ofgem intends to translate this to 2018/19 price base for input into the PCFM, although we note the formula within the PCFH (paragraph 2.9) to convert to 2018/19 price base. • The T1 formula utilises ‘I’ for income earned in FY21, the average specified rate to reflect Time value of Money. If we are to utilise this formula for the incentive values that fall into T2 then this would mean using ‘I’ for Time Value of Money. However, as the Draft Determinations propose the potential use of SONIA in RIIO-2 for all Time value of Money calculations, the use of ‘I’ for legacy incentives would appear to diverge from RIIO-2 policy. For legacy MODs Ofgem has used the T2 WACC policy, therefore it would be inconsistent to use T1 Time value of money policy for incentives, rather than RIIO-2 policy. The use of either I or SONIA should be explicitly referenced in the T2 licence drafting to enable transparency and remove any ambiguity.
SUPPORTING INFORMATION	
OFGEM ENGAGEMENT:	