

CROSS SECTOR	
REFERENCE NUMBER:	CATEGORY: Addition
LICENCE CONDITION NUMBER: <i>(if relevant):</i>	ET: SpC 2.1/ SpC 2.2/ SpC 2.3/ SpC 2.4 GT: SpC 2.1/ SpC 2.2/ SpC 2.3/ SpC 2.4/ SpC 2.5/ SpC 2.6/ SpC 2.7/ SpC 2.8
TITLE:	Chapter 2: Revenue Restrictions
RELEVANT LICENCE CONSULTATION QUESTIONS <i>(if any):</i>	
RELEVANT ISSUES LOG:	
POLICY ISSUES	
<ul style="list-style-type: none"> ET SpC 2.1.5 and GT SpC 2.1.6 and SpC 2.5.6 SpC 2.4 and GT SpC 2.8 SpC 2.4.5 and GT SpC 2.8.5 SpC 2.4.5(d) and GT SpC 2.8.5(d) 	<ul style="list-style-type: none"> Paragraph 2.1.5 for ET and 2.1.6 for GT states “The value of ART is not revised following publication”. This is inconsistent with concept of “self publication” referred to in paragraph 4.52 of the consultation paper and limits the ability of the licensee to maximise the cost reflectivity of charges. We refer to our responses to consultation questions Q11 and Q12. In any case, this wording is not required as explained below. In relation to the tax review, we note Ofgem’s reluctance to establishing a backstop to this review due to the potential for a CT600 to be amended after it has been submitted to HMRC (e.g. through enquiry). We acknowledge this fact but also note that there are also time limits to when, and how, a submitted CT600 can be amended within tax legislation. We also consider it important to provide licensee with certainty over when a Tax Review can take place. We therefore recommend that the time limit for a tax review is linked to when a CT600 return is considered closed/agreed with HMRC. For example, time limiting a Tax Review to say, for example, 6 months after a CT600 has been agreed with HMRC would allow Ofgem time to understand any changes to historic CT600s and undertake a Tax Review if considered appropriate. In SpC 2.4.5 and GT SpC 2.8.5, given that the proposal is that the licensee is obliged to ensure that the Appropriately Qualified Independent Examiner’s report is completed by the date and to the scope specified, this is potentially an onerous obligation. We suggest it would be more appropriate for this condition to be a reasonable endeavours obligation. In addition, to ensure that the licensee can comply, we request that the licence condition provides for the licensee to be consulted on the proposed scope and timing In SpC 2.4.5(d) and GT SpC 2.8.5(d), in circumstances where Ofgem has set the terms of appointment for the Appropriately Qualified Independent Examiner’s report and the form of the report, it should not also be for Ofgem to

	determine the content of the report. That is a matter for the Appropriately Qualified Independent Examiner to determine. We are not clear what is intended by this wording.
DRAFTING ISSUES	
<ul style="list-style-type: none"> • General • General • SpC 2.1.3 • ET SpC 2.1.4 – 2.1.5, GT SpC 2.1.5-2.1.6, 2.5.5-2.5.6 • SpC 2.1.7, GT SpC 2.5.7 	<ul style="list-style-type: none"> • The terminology in the licence is different to that in the PCFM with Directly Remunerated Services (DRS) used in the licence and Excluded Services in the PCFM. DRS should be used consistently throughout licence conditions and financial instruments. • There are some issues with sub-paragraph numbering across Chapter 2 and some paragraphs do not end with a full stop. • In SpC 2.1.3, there is a missing comma before “use”. • In ET SpC 2.1.4 - 2.1.5 / GT SpC 2.1.5-2.1.6: <ul style="list-style-type: none"> ○ The definition of AR_t (applicable equally to $SOAR_t$) is currently unclear and does not align with the AIP condition. The definition needs to make clear that AR_t will be as published by Ofgem under Part B of SpC 8.2, having been derived in accordance with the relevant formula or (in the absence of such a publication) as otherwise determined under Part C of SpC 8.2. We suggest changing the drafting to “<i>The value of AR_t is the value published by the Authority pursuant to Special Condition 8.2, having been derived in accordance with the following formula [insert formula] or as otherwise determined under Part [C/D] of SpC 8.2</i>”. ○ There is in any case no need to refer to the value not being revised, in circumstances where the definition is clear how AR_t is set. • In SpC 2.1.7 and GT SpC 2.5.7: <ul style="list-style-type: none"> ○ It is not correct to state that the values which form R_t (applicable equally to SOR_t) are as published under SpC 8.2. That condition does not require the publication of the values listed and some terms (such as ODI_t) are derived from the licence directly rather than the PCFM. We suggest deleting this wording and adding at the end of the provision “...where for these purposes the values set out in the PCFM shall be those which are used to determine AR_t”. ○ The definitions of the Calculated Revenue components in SpC 2.1.7 reference the GD2 PCFM so require amendment to refer to the GT2 or ET2 PCFM as relevant. ○ The definition of ‘DRS’ within SpC 2.1.7 and GT SpC 2.5.7 requires referencing to SpC 9.7. We suggest wording of “derived in accordance with Special Condition 9.7” is added to the definition of the term. This will provide

<ul style="list-style-type: none"> • SpC 2.4.5 • Definitions • SpC 2.1.7 • Definitions • SpC 2.1.2 • SpC 2.1.3 • SpC 2.1 Part A • SpC 2.3.2 and SpC 2.7.2 • SpC 2.5.4 • SpC 2.5.6 	<p>linkage to the value calculation within the licence. The deduction of DRS in derived Allowed Revenue is already captured through reference to the negative signage value through the PCFM reference.</p> <ul style="list-style-type: none"> • In SpC 2.4.5, the way SpC 2.4.5(b) is currently drafted makes it unclear whether it is referring to the same procurement as referred to in SpC 2.4.5(a). We suggest changing this to “<i>carry out the steps specified by the Authority for <u>such a procurement</u> and...</i>”. • The term AIP is used in drafting, but this is not a defined term. <p><u>The following comments are in relation to NGET only:</u></p> <ul style="list-style-type: none"> • In SpC 2.1.7, a number of the titles of conditions references are quoted inaccurately. • The definition of Transmission Network charges is missing from the Definitions Excel file and other documents, although the Excel file includes the definition of Transmission Network Charges. <p><u>The following comments are in relation to NGG only :-</u></p> <ul style="list-style-type: none"> • In SpC 2.1.2, this should refer to the term RR_r (the TO Recovered Revenue term). • In SpC 2.1.3, this should refer to TO Recovered Revenue. • We suggest that the heading of Part A should be “<i>Licensee’s obligation when setting NTS Transportation Owner Charges</i>”. • In SpC 2.3.2 and SpC 2.7.2, it is not clear why this refers to “<i>a target published by the Authority prior to Regulatory Year t</i>”. We suggest that this should refer to Allowed Revenue as set out in the formula. • In SpC 2.5.4, the cross-reference for $RADD_t$ should be to SpC 4.4.5. • Part C, paragraph 2.5.6 references the term ART. Special Condition 2.5 includes the definition for $SOART$, the SO Allowed Revenue and therefore the Allowed Revenue references in paragraph 2.5.6 should be changed to $SOART$. However, we note as above that we propose a different formulation.
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<ul style="list-style-type: none"> • SpC 2.5.7 • SpC 2.7.2 	<ul style="list-style-type: none"> • In SpC 2.5.7, the cross-reference for SOLAR_t should be SpC 7.9. • In SpC 2.7.2, the condition reference is incomplete.
FINANCE ISSUES	
<ul style="list-style-type: none"> • SpC 2.1 – 2.7 	<p><u>ARt (and SOARt for GT only)</u></p> <ul style="list-style-type: none"> • The following comment applies to both the ADJ and SOADJ terms. However, for brevity we include reference only to ADJ here. <p>The ADJ term calculates the revenue impact in prior years relating to updated delivery and performance. The principle revenue formula then incorporates this revenue adjustment into the Allowed Revenue calculation.</p> <p>We understand that the intent is to calculate prior year revenue impact by comparison of the Calculated Revenue in a particular Regulatory Year with the Calculated Revenue in the previous iteration of the PCFM.</p> <p>The error in calculation arises due to the definition of the Calculated Revenue as per the previous iteration of the PCFM (ADJR). Special Condition 2.2 Part B paragraph 2.2.4 defines that Calculated Revenue “<i>for Regulatory Year t, as of the AIP publication in Regulatory Year t-1</i>”. The reference to the publication in Regulatory Year t-1 is both confusing and incorrect. The Annual Iteration Process used to calculate Allowed Revenue for Regulatory Year t, will occur in year t-1. For example, the Allowed Revenue for Regulatory Year 2023/24 is calculated through the November 2022 Annual Iteration Process. Therefore, application of the t-1 Regulatory Year to refer to a previously published revenue results in use of the Calculated Revenue within the current PCFM as a comparative figure. Therefore, the ADJ term will always be zero as the comparative revenue is the same value (from the same iteration of the PCFM) as the current revenue for a given Regulatory Year. The PCFM does not align with this algebra and assumes that the comparative revenue term is taken from the previous publication of the PCFM.</p> <p>In order to align the licence with the PCFM treatment, amendment is required to the licence algebra. We appreciate that Ofgem has chosen to use a single term, Regulatory Year, to reference time bound calculations. If Ofgem prefer not to use an alternative definition to reference the year in which the Annual Iteration Process is carried out, we suggest reversion to wording in line with the RIIO-T1 framework which referred to prior year revenue changes as a result of updating the PCFM as the incremental change for year t.</p> <ul style="list-style-type: none"> • The following comment applies to both the ADJ and SOADJ terms. However, for brevity we include reference only to ADJ here.

<ul style="list-style-type: none"> • SpC 2.2 	<p>Even correcting for the error noted in the previous sections, the ADJ term still requires further revision to correctly reflect the magnitude and direction of adjustments to historic revenues.</p> <p>We have identified a further error within the calculation of the ADJR term (SpC 2.2.4 and for GT only, SpC 2.6.4) which results in the ADJ adjustment being adjusted for in each subsequent year, with the direction of adjustment being the reverse of the prior year. This impacts every year from the first Regulatory Year after which the initial ADJ adjustment was made onwards.</p> <p>The ongoing annual adjustment occurs as a result of the algebra used to calculate ADJR. The current Calculated Revenue for a given Regulatory Year is compared to the Calculated Revenue for the Regulatory Year as per the previous Annual Iteration Process plus the ADJ adjustment used to describe the revenue catch up for previous years. The inclusion of the ADJ adjustment in the comparison is incorrect and results in the perpetual cycle of annual ADJ adjustments.</p> <p>There is no net impact on the Allowed Revenue term as, for all years post the Regulatory Year in which the initial ADJ adjustment is applied, the K term is calculated to include an adjustment equal in magnitude but opposite in sign to the ADJ term (SpC 2.3.3 for ET and SpC 2.3.4 and SpC 2.7.4 for GT). The cumulative impact of 5 years of adjustment to prior year performance is also likely to result in ADJ and K terms of increasing magnitude across the price control period.</p> <p>Whilst the overall magnitude of Allowed Revenue may be correct, the values reported under ADJ and K will not correctly reflect the performance and level of revenue recovery delivered by the licensee. This is misleading from a reporting perspective.</p> <p>We note however, that the PCFM does not align with the licence algebra and correctly compares Calculated Revenue values from the current and previous versions of the PCFM.</p> <ul style="list-style-type: none"> • The ADJ_t calculation in SpC 2.2.4 (and GT SpC 2.7.4) uses i and j to define the Regulatory Years to be used within the calculation. The definition of i,j requires revision to “refer to Regulatory Year <u>from</u> 2021/22 <u>to</u> Regulatory Year t-1, <u>inclusive</u>” to ensure the correct range of years is included. • SpC 2.2.4 (and GT SpC 2.6.4) references the Calculated Revenue as per the previous AIP iteration. It is AR_t that is published, rather than R_t. In addition, the revenue published within the Final Determinations documentation are not strictly part an Annual Iteration Process, which is defined in the regulatory instruments as entailing the population and running of the PCFM by the licensee. This issue is resolved by referring instead to prior year revenue changes as a result of updating the PCFM as the incremental change for year t.
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<ul style="list-style-type: none"> • SpC 2.1 • SpC 2.5 	<p><u>The following comments are in relation to NGG only :-</u></p> <ul style="list-style-type: none"> • The calculated revenue formulae in the PCFM contains the business plan incentive (BPIt) within the summation. However, the business plan incentive does not feature in the algebraic definition of R_t in SpC 2.1.7. The formula in 2.1.7 therefore requires updating to include the BPIt term. • SpC 2.5.7, Part D: Formula for calculating the SO Calculated Revenue term (SORt) includes the term SOINNV and references SpC 5.1 for the derivation of this term. However SpC 5.1 only defines INNV, the TO element of innovation. Terms within the SO Allowed Revenue formula require definition within the relevant Special Condition.
SUPPORTING INFORMATION	
OFGEM ENGAGEMENT:	