

ET SECTOR	
REFERENCE NUMBER:	CATEGORY: Addition
LICENCE CONDITION NUMBER: (if relevant):	SpC 6.2
TITLE:	Competition Proxy Model pass-through cost and Re-opener
RELEVANT LICENCE CONSULTATION QUESTIONS (if any):	
RELEVANT ISSUES LOG:	NA
POLICY ISSUES	
<ul style="list-style-type: none"> General General SpC 6.2.4 (Qualifying Assets) SpC 6.2.4 (CPM / LOTI) SpC 6.2.7 (LOTI policy changes) 	<ul style="list-style-type: none"> We continue to have concerns regarding the design and implementation of the proposed CPM mechanism, which has come at the consequence of the lack of development of a true-form of competitive model and as such does not deliver benefits but instead is a detriment to real consumer value. We formally responded with our concerns to the Draft Determinations (please see Q32 of DD Core document response for a detailed response to our CPM concerns). Any comments in this response are subject to our previous response on CPM and we do not agree with its inclusion in the licence. Nevertheless, there are several major policy issues arising from the proposals in the consultation. Ofgem stated in its Draft Determination (DD Core document, p.165) that “<i>Late Project Deliverable proposals may be applied</i>” to CPM projects. The licence consultation provides no further clarity on this proposal. The drafting should confirm that that any elements of the Qualifying Assets constituting the LOTI that are to be treated as a CPM project must, on a standalone basis, satisfy the new, high value and separable criteria for competition (which, as noted below, should be on the face of the licence). We suggest that “<i>some or all of</i>” should be deleted. Once Ofgem has directed that a project should be treated as a CPM Project, there must be the potential that circumstances change, and this is no longer desirable. We suggest that the condition should include a mechanism for a project to be moved from CPM back to a LOTI delivery at the application of the licensee. We welcome the information regarding the timing of a CPM Needs Case submission (after material planning consents). We are however, aware there continue to be policy discussions around the LOTI INC and FNC submissions timing, with the view of having a more flexible submission timeline. As CPM submissions are aligned to

<ul style="list-style-type: none"> • SpC 6.2.8 (Absolute licence obligation) • SpC 6.2.10 (Mid Construction Review timing) • SpC 6.2.12 (Post Construction Review) • SpC 6.2.13 (Post Construction Review Report) • SpC 6.2.14 (a) (Operational Cost Adjustment) 	<p>LOTI submissions, we request that timings in this condition are adjusted to align with any changes to the LOTI licence condition.</p> <ul style="list-style-type: none"> • The licence condition includes an (absolute) obligation in SpC 6.2.8 that the outputs must be delivered by the delivery date specified, although this is not explained in the consultation document. We do not consider that it is proportionate to add such a licence obligation and no justification for this has been provided. In addition, the drafting is not consistent with the obligation as referred to in the Draft Determination (DD Core document, p.165), where it was stated that Ofgem “<i>would consider <u>whether</u> any late delivery... constituted a breach...</i>” (emphasis added). The drafting creates an automatic breach for late delivery, regardless of the circumstances. We suggest that Ofgem’s ability to issue a Post Construction Review Direction, along with general licence and statutory obligations on licensees make any further obligation here inappropriate. • There is inconsistency between the drafted licence, guidance and the draft determinations on the timings of when the Mid Construction Review can be submitted. Licence drafting states 90% of cost spent or committed while in DD and CPM Guidance, it references 90-95% of cost spent or committed. In additional drafting here states ‘and’ while in guidance its states ‘or’. We request clarity on the policy for Mid Construction Review. • The CPM Post Construction Review stage is very unclear in the licence condition and it is not proportionate to have an unlimited provision allowing for the changing of the CPM Output, delivery date and allowances after the event. Further, the provision is far broader than suggested under the current draft of the CPM Guidance. We request that Ofgem further engages with networks on this detail. • There is inconsistency between the drafted licence paragraph and the draft CPM Guidance document upon when the Post Construction Review report should be provided. SpC 6.2.12 states that this should be provided within 3 months of the CPM Delivery Date, while the draft CPM Guidance states that the process will start within 12 months of delivery of the date that the CPM Output is delivered. We suggest that it would be appropriate for the deadline for the report to be 12 months of the CPM Output being delivered (which may, of course, be different from the CPM Delivery Date). This would allow time for licensees to submit a detailed post construction report to Ofgem where all information is available and following appropriate assurance checks. • In SpC 6.2.14(a), we do not agree that the test of “reasonable foreseeability” is an appropriate threshold to apply to the CPM Operational Cost Adjustment Direction. Such a test may be appropriate in a competitive mechanism where the risk of foreseeable events is borne by bidders in their bids. But here, networks have a cost assessment imposed
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<ul style="list-style-type: none"> • SpC 6.2.14 (c) (Cost Adjustment Threshold) • SpC 6.2.15 (Notification Timing) • SpC 6.2.16 (Project costs prior to decision) • SpC 6.2.17 (Licence modification) • Definitions (Criteria for Competition) • Definitions (Operational Period) 	<p>by Ofgem. We suggest that the test here should be whether or not the cost increase is beyond the control of the licensee, as used in SpC 6.2.9 in relation to the CPM Mid Construction Review.</p> <ul style="list-style-type: none"> • The CPM Operational Cost Adjustment Threshold is a significant long-term risk to networks, as up to this threshold, networks will need to absorb the costs. We request that Ofgem further engages with networks on this detail. • We are concerned that the timings relating to the CPM Operational Cost Adjusting Event application are not proportionate and are unlikely to be efficient. Over a 25-year operational period, having only 14 days to notify of an event will mean that networks have not had time to properly consider the impact, but will need to make notifications while issues are still uncertain. Similarly, 30 days does not allow sufficient time to compile all appropriate evidence on the impact. As a proportionate alternative, we suggest that, in both cases, the timing should be within three months and that the notification should also be required as soon as reasonably practicable. • While networks await the Project Assessment Decision, we request that Ofgem confirm its position on taking the project forward. Is the expectation that projects are progressed at risk or provisions given by Ofgem to progress while a decision is made by Ofgem? If so, what would that be? We note that the current Pre-Construction Funding licence condition does not cover CPM projects, but also that Ofgem has stated in the Draft Determination (Core, para 9.21) that no work should be carried out that could be detrimental to projects being suitable for competition. • We welcome Ofgem's inclusion of licensees' request that a Project Assessment Decision should be implemented by licence modification. However, we do not see that there is any rationale for the Project Assessment Decision to make changes to Appendices 1 and 2 (and so revenues) by licence modification while other changes to those appendices are by direction. We suggest that each of the CPM Mid Construction Review Direction, the CPM Post Construction Review Direction and the CPM Operational Cost Adjustment Direction should be by licence modification. This reflects the importance of these investment projects to the overall price control and the novelty of the CPM mechanism. • The scope of the mechanism is very important. We need stability and certainty in the licence over the projects that may fall within the mechanism. We do not agree that Ofgem's criteria for competition are not on the face of the licence and may be changed following consultation. We request that appropriate drafting is set out in the licence to define what may become a CPM project. • We note that no definition is proposed for Operational Period and so this needs further consideration. As part of this, Ofgem should consider further how it will address the risk to the licensee of Ofgem making changes to the
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	<p>licence condition during the operational period. Unlike a true competitive model, the parties are not bound to an agreement dealing with the term – this leads to considerable risk for the licensee.</p>
DRAFTING ISSUES	
<ul style="list-style-type: none"> • General • SpC 6.2.2 • SpC 6.2.3 • SpC 6.2.4 • SpC 6.2.7 • SpC 6.2.8 • SpC 6.2.9 • SpC 6.2.10 	<ul style="list-style-type: none"> • There are several significant issues with the drafting surrounding the decisions which Ofgem would make around CPM Mid Construction Reviews, CPM Post Construction Review, the CPM Operational Cost Adjustment Direction and the CPM Project Assessment Direction. This includes a lack of clarity around what falls within the scope of each of these decisions and the introduction of terms which are not defined. We have set out below our understanding of what the drafting should cover based on our understanding of Ofgem’s policy intention. However, we request further bilateral discussion with Ofgem to ensure a clear policy that is matched by the drafting. • We suggest that this should be amended to summarise SpC 6.2.4, in addition to the current wording (since the direction that CPM will apply is an important part of the condition). • In SpC 6.2.3, we suggest referring to “<i>allowances</i>” and not “<i>revenue allowances</i>” as this is not a term used elsewhere (see SpC 3.2.4 as an example). The definitions should also refer to the sum “<i>for the Regulatory Year</i>” as the appendices will cover allowances for more than one year. • In SpC 6.2.4, ‘<i>if it considers it appropriate to do so</i>’, is unnecessary drafting. • In SpC 6.2.7, our understanding of the intention is that approval “<i>...may only...</i>” be sought from Ofgem to the specified timescale and we suggest that this drafting change is made. The provision should not be stated as an obligation to send a CPM Needs Case to Ofgem. • We suggest replacing “<i>the delivery date specified in Appendix 1</i>” with “<i>the CPM Delivery Date</i>” (defined term). • Our understanding is that this should refer to “<i>...amending <u>any</u> of the CPM Output, CPM Delivery Date and the allowances <u>set out</u> in Appendix 1...</i>”. • Is the intention that <u>any</u> application must be at least one year before the CPM Delivery Date or does this requirement not apply for applications falling within SpC 6.2.10(b)?

<ul style="list-style-type: none"> • SpC 6.2.13 	<ul style="list-style-type: none"> • As noted above, SpC 6.2.13 is not consistent with the draft CPM Guidance. However, it is also stated that there <u>may</u> be such a direction, whereas under SpC 6.2.20, this is needed to set certain operational provisions.
<ul style="list-style-type: none"> • SpC 6.2.15(b) 	<ul style="list-style-type: none"> • We suggest that this should refer to “...<u>provide any evidence available</u> that the conditions in paragraph 6.2.14 have been met”. The evidence is provided to support the application, rather than as a standalone obligation.
<ul style="list-style-type: none"> • Part H heading 	<ul style="list-style-type: none"> • It is not consistent with the licence generally to use questions as headings. We suggest changing to “<i>Process for making decisions and directions under this condition</i>”.
<ul style="list-style-type: none"> • SpC 6.2.16 	<ul style="list-style-type: none"> • CPM Construction Cost of Capital is not defined.
<ul style="list-style-type: none"> • SpC 6.2.18 	<ul style="list-style-type: none"> • SpC 6.2.18 should cross-reference SpC 6.2.4, SpC 6.2.9, SpC 6.2.13 and SpC 6.2.14.
<ul style="list-style-type: none"> • SpC 6.2.19 	<ul style="list-style-type: none"> • Our understanding is that the drafting of SpC 6.2.19 should align with SpC 6.2.9 (set out above).
<ul style="list-style-type: none"> • SpC 6.2.20 	<ul style="list-style-type: none"> • Our understanding is that the drafting of SpC 6.2.20 should align with SpC 6.2.13. However, this provision currently refers to additional elements and misses out others. The two provisions should be consistent.
<ul style="list-style-type: none"> • SpC 6.2.26 - SpC 6.2.27 	<ul style="list-style-type: none"> • There is a lot of duplication between these two provisions and we suggest that they could be condensed into a single provision.
<ul style="list-style-type: none"> • Appendices 	<ul style="list-style-type: none"> • The years between Appendix 1 and 2 do not align, if construction is to end in 2026/27, we expect that operations would commence 2027/28? in addition, the operation years should be for 25 years, currently annual operations are for more than 25 years.
<ul style="list-style-type: none"> • Appendix 1 	<ul style="list-style-type: none"> • There is no definition for CPM Allowed First-Year Operational Revenue, and it is unclear what the purpose of the addition is to the table.
<ul style="list-style-type: none"> • Appendix 2 	<ul style="list-style-type: none"> • SpC 6.2.14 states a direction will be made to adjust the allowance in Appendix 2, however, the wording in Appendix 2 for operational cost is ‘Allowed Operational Cost’, while the wording in Appendix 1 utilises ‘CPM Construction Cost Allowance’. For consistency, we suggest ‘Allowed Operation Costs’ is changed to ‘CPM Operational Cost Allowance’.

<ul style="list-style-type: none"> Definitions 	<ul style="list-style-type: none"> CPM Sharing Factor is defined, but it is not made clear in the condition what purpose the sharing factor serves (or how many sharing factors may be applied). In the definition of CPM Financial Model, it is not correct to refer to “<i>determining the value of the CPMt term</i>”. The model is used “<i>to determine the allowances for the CPM project</i>”. We suggest renaming the CPM Guidance on the basis that guidance implies the document to be advisory in nature, whereas SpC 6.2.22 provides that it is mandatory. Some CPM definitions do not appear to be used, such as CPM Allowed Operational Revenue.
FINANCE ISSUES	
<ul style="list-style-type: none"> PCFM 	<ul style="list-style-type: none"> Current PCFM design suggests that all revenue calculations for CPM will be done in standalone models and then fed into PCFM as part of other pass through costs. No term exists in PCFM for CPMRt. We are concerned that multiple PCFM will be in existence covering individual CPM projects and RII price control periods.
SUPPORTING INFORMATION	
OFGEM ENGAGEMENT:	