Decision

NARM Handbook Updates: Threshold for justifying Clearly Identifiable Over or Under Delivery and Related Amendments

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We consulted from 3 April 2025 to 9 May 2025 on a number of amendments to the Network Asset Risk Metric (NARM) Handbook. The consultation proposed amendments to NARM Handbook and including proposed amendments to the to the upper and lower threshold values for the Unit Cost of Risk (UCR) in determining whether a delivery element qualifies as a Clearly Identifiable Over or Under Delivery NARM Funding Adjustment and Penalty Mechanism.

This document sets out our[1] decision to proceed with amendments that were subject to statutory consultation published on 3 April 2025. The changes support the full operation of the NARM mechanism, ensuring companies accountable for Baseline Network Risk Outputs (BNRO) delivery while mitigating against non-cost reflective outcomes.

[1] The terms 'the Authority', 'Ofgem', 'we' and 'us' are used interchangeably in this document. The Authority is the Gas and Electricity Markets Authority. Ofgem is the office of the Authority

Structure of this Decision Document

This document is split into 3 chapters:

- The introduction provides an overview of the policy and statutory consultations;
- Chapter 2 provides the context for this decision;
- Chapter 3 sets out our proposals, stakeholder responses and Final Decision; and
- Chapter 4 sets out next steps

Alongside this document we are publishing the following:

- Non-confidential responses to our 3 April 2025 Statutory consultation[2].
- Updated NARM Handbook v4.0
- Redlined version of the NARM Handbook, reflecting amendments made following the statutory consultation
- Issues log
- Electricity and gas decision notices for Special Condition 3.1

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[2] Network Asset Risk Metric handbook: clearly identifiable threshold statutory consultation | Ofgem

Contents

1. Introduction

Background

1.1 Gas and electricity network companies are required to provide safe, secure, reliable and efficient energy network services. Those regulated through the RIIO price controls are funded to carry out activities such as the replacement or refurbishment of assets in order to ensure that the risks to consumers associated with network failure are maintained within reasonable bounds. We developed the NARM framework to allow us to quantify the benefit to consumers of these asset management activities.

1.2 Each company maintains a NARM Methodology which details how they calculate Monetised Risk on their network. Monetised Risk is generally determined through multiplication of the probability of asset failure by the monetised value of the consequences of the failure (e.g. the value of interruption to supply, or cost of damage to the environment, etc.). Monetised Risk is the primary measure for defining the outputs and setting allowances associated with asset management activities.

1.3 The network companies' RIIO-2 business plans contained a range of proposed investments, some of which deliver Monetised Risk benefits (mainly replacement and refurbishment of existing network assets), and others that do not deliver a Monetised Risk benefit (such as installation of new network assets, or investment in non-network assets, or network assets not covered by the NARM Methodology).

Overview of Policy and Statutory Consultations

1.4 We used a range of techniques, including econometric and engineering assessments, in determining which investments should be funded during RIIO-2 (through baseline funding), which investments should be subject to uncertainty mechanisms (such as volume drivers), and which investments should be disallowed completely.

1.5 The mechanism by which network companies are held to account for their Baseline Network Risk Outputs (BNRO) delivery during RIIO-2 is known as the NARM Funding Adjustment and Penalty Mechanism. Under this mechanism, some financial adjustments and penalties are applied depending on the network company's delivery versus their BNRO and the extent to which any over-delivery or under-delivery is deemed to be justified.

1.6 Our approach to applying the NARM Funding Adjustment and Penalty Mechanism is set out in our RIIO-2 Final Determination NARM ANNEX.[3] We explained that companies will be expected to justify deviation in delivery from their output targets. However, we also introduced a deadband around the BNRO within which justification will not be required and we set out the size of the deadband for each of the sectors: ±2% for Electricity Transmission and ±5% for Gas Transmission and Gas Distribution.[4]

1.7 Separately, we introduced an additional element to the NARM Funding Adjustment and Penalty Mechanism for Clearly Identifiable Over or Under Delivery (CIO/UD). This mechanism is designed to provide bespoke funding adjustments in the case of over- or under-deliveries that would not be appropriately compensated through the automatic funding adjustment mechanism.

1.8 The NARM Handbook sets the guidance and qualifying criteria for CIO/UD; however, there are elements of the CIO/UD guidance which were not fully developed, owing to the need for us to conduct further assessments.[5]

1.9 In July 2024, we conducted a policy consultation on the proposed amendments to the CIO/UD guidance provided in the NARM Handbook[6]. This was followed by our policy decision in November 2024,[7] which set out our minded to position on the CIO/UD thresholds we consider appropriate in enabling the CIO/UD element of the NARM Funding Adjustment and Penalty Mechanism to effectively mitigate against the risk of non-cost reflective losses and gains. Our policy decision also related to several additional amendments, which are detailed in Chapter 2 of this decision.

1.10 The NARM handbook forms part of Special Condition 3.1 (Baseline Network Risk Outputs) and as such is part of the licence. Therefore, following our policy consultation, we consulted through our April statutory consultation as required

[3] RIIO-2 Final Determinations NARM Annex (REVISED (ofgem.gov.uk)

[4] The lower deadband for ET reflects the relatively higher cost of the individual investments

[5] Decision on the proposed modifications to the RIIO-2 Transmission, Gas Distribution and Electricity System Operator licence conditions - 1 April 2022 | Ofgem: NARM Documents 030222, NARM_Handbook_v3.1.pdf

[6] This CIO/UD consultation document provides the background to this assessment (including the full rationale and analysis behind our proposed amendments) Threshold for justifying Clearly Identifiable Over or Under Delivery under the NARM Funding Adjustment and Penalty Mechanism

[7] Section 2 of our decision document provides a summary of the responses we received to the consultation; along with how this has informed our policy decision: Qualifying criteria for Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery under the NARM Mechanism | Ofgem

by Special Condition 3.1.17 (SpC3.1.17)[8] of the Transmission and Gas Distribution licences. We received seven responses on our proposed modifications to the draft NARM Handbook, which we set out in more detail in Chapter 3.

[8] Special Condition 3.1 Part E: NARM Handbook

2. Context

Overview of NARM framework and funding mechanisms

2.1 NARM is a central to ensuring energy network companies are maintaining their assets responsibly and efficiently; contributing to articulating consumer benefit within cost benefit analyses (CBAs). NARM allows for different asset intervention options to be assessed on a comparative basis (in terms of their network risk output), stating risk outputs upfront and monitoring progression throughout the price control.

2.2 Network licence conditions tie allowed funding through NARM to the delivery of a certain amount of network risk output (the BNRO). To the extent that network companies under- or over-deliver against this BNRO over the price control period, funding adjustments and penalties can be applied at close out. The NARM Handbook specifies the methodologies by which such funding adjustments and penalties are applied.

NARM Funding Adjustment and Penalty Mechanism

2.3 The NARM Funding Adjustment and Penalty Mechanism is principally designed to work by anchoring ex-post funding adjustments to pre-determined ratios between funding (£m) and the network risk output this funding is expected to deliver (R£m). This is what we will refer to in this document as the '*automatic'* funding adjustment mechanism.

2.4 Elements of over- and under-delivery on network risk output that qualify as 'clearly identifiable' are intended to be separated out of this 'automatic' adjustment mechanism, with appropriate funding adjustments for these delivery elements then applied on a case-by-case basis.

2.5 In effect, there are two channels to determining the final allowed NARM expenditure for a licensee at close out:

- the 'automatic' funding adjustment mechanism which uses the baseline ratio between allowed funding and network risk output to adjust funding in cases where the delivered network risk output deviates from baseline; and
- the 'clearly identifiable' mechanism which enables bespoke funding adjustments for qualifying over- or under-delivery elements.

Unit Cost of Risk (UCR)

2.6 The relationship between funding and risk output is formalised as the Unit Cost of Risk (UCR), defined as the average funding per unit of network risk output delivered (£/R£). This UCR is applied at aggregate levels, rather than on a project-by-project (or programme of work) basis, with the specific application for each sector as follows:

- For Electricity Transmission, a unique UCR is defined for each of seven different asset sub-categories.
- For Gas Transmission, a unique UCR is defined for each of three different risk levels (low, medium and high).
- For Gas Distribution, a single UCR is defined for each licensee as a whole.

2.7 While there are these differences by sector, going forward we use the phrase 'risk sub-category' to refer to all such scenarios for simplicity.

2.8 For all sectors, the UCR forms the basis for adjusting funding allowances in line with deviations in the delivered network risk output from baseline expectations. As such, UCRs are critical in determining the final funding allowances that licensees receive.

2.9 The application of UCR in the funding adjustment process avoids the need for ex-post project-by-project assessment across all NARM investments.

2.10 However, our assessments have identified that there are certain cases where use of the UCR can result in a problematic basis for an automatic funding adjustment mechanism. This is because our analysis[9] showed there is a lack of correlation between baseline funding and network risk output, owing to the 'automatic' funding adjustments being anchored to a single baseline UCR within the overall risk sub-category; and as such, a separate bespoke adjustment should be considered that is more reflective of the project-specific risk outputs and costs. It is in these cases that the 'clearly identifiable' mechanism is applied.

[9] Please refer to Section 3 of our consultation on the policy decision, which outlines the details of this analysis: Threshold for justifying Clearly Identifiable Over or Under Delivery under the NARM Funding Adjustment and Penalty Mechanism

Clearly identifiable over-delivery and under-delivery

2.11 The NARM Handbook states that for projects/schemes/programmes of work which are clearly identifiable as driving an over-delivery or under-delivery, these initiatives will be considered outside of the delivered output and cost out-turn and a separate adjustment will be made to the final NARM allowance. For these projects, the final allowed expenditure for these delivery elements will not be based on the underlying UCR for the risk sub-category in question, but rather a bespoke assessment of the cost and risk output characteristics of that specific project.

2.12 The qualifying criteria for clearly identifiable under and over-delivery elements are specified in Section 10 of the NARM Handbook and replicated below.

Qualifying criteria for clearly identifiable over-delivery or under-delivery

10.5 To qualify as Clearly Identifiable Over-Delivery, an Over Delivery element must meet the following criteria:

1. *Outputs and costs must both be quantifiable and separable from the overall delivery (e.g. a specific project);*
2. *The Over-Delivery element must not have been specified within the licensee's RIIO-2 Business Plan, or if specified, must have been specifically excluded from BNRO at Final Determinations as reflected in the NARM Workbook (NARW);*
3. *The Over-Delivery element must not be specified in NARM Funding Category A3; and*
4. *The Over-Delivery element must have an outturn UCR greater than a specified upper-threshold, or less than a specified lower-threshold value (see paragraph 10.9 for further detail on these values).*

10.7 In order to qualify as Clearly Identifiable Under-Delivery, an Under-Delivery element must meet the following criteria:

1. *Outputs and costs must both be quantifiable and separable from the overall Under-Delivery (e.g. a specific project);*
2. *The Under-Delivery element must be included in the licensee's BNRO and individually specified in its NARM Workbook (NARW);*
3. *The Under-Delivery element must not be specified in NARM Funding Category A2 or A3; and*

4. *The Under-Delivery element must have a UCR greater than a specified upper-threshold, or less than a specified lower-threshold value (see paragraph 10.9 for further detail on these values).*

2.13 In each case, the fourth criteria states that in order to qualify the over- or under-delivery element must have a UCR greater than a specified upper-threshold and less than a specified lower-threshold.

2.14 The setting of this UCR threshold is important insofar as it impacts which NARM projects can be processed through the 'automatic' funding adjustment mechanism, and which cannot (and must instead be treated as 'clearly identifiable'). In doing so, the choice of UCR threshold for 'clearly identifiable' determination will ultimately impact licensees' final allowed expenditures calculated at close out.

2.15 When published in February 2022, the NARM Handbook stated that we would undertake further analysis before consulting on the appropriate level of the upper and lower threshold values.

3. Consultation responses and Ofgem's Decision

In this chapter we summarise what we consulted on in April and our decision to proceed with implementation. We proposed several amendments to the NARM Handbook, including setting UCR thresholds for Clearly Identifiable Over- and Under-Delivery at 105% and 95% of a given risk sub-category; Outturn NROs and costs should be reported by project for ET, and by programme for GD and GT and amending the second qualifying criterion for Over-Delivery to include reduced-scope projects with fewer asset interventions; and Justification percentages should be weighted by each project's contribution to overall NRO variance.

We summarise the key themes from the stakeholder responses we received on our proposals, with most stakeholders supporting our proposals and the requirement for these modifications, however points of clarification were sought.

We have taken a decision to implement the proposed amendments that we consulted on but, in response to stakeholder feedback, we have made some changes. Most notably, these changes are centred around clarifying the calculation term CIX_OD—which appears with differing definitions in Sections E and F of the NARM Handbook, these should be treated as two distinct terms, as this inconsistency has caused confusion over its use in determining a licensee's Final Allowed Expenditure (see paragraph 3.54 below).

3.1 There were seven respondents to the consultation, all of whom were network companies: National Gas, three Transmission Operators (TOs), and the Gas Distribution Networks (GDNs).

3.2 While most respondents provided detailed answers to the consultation questions and specific feedback on the proposed updates to the NARM Handbook, some offered only general comments or responded selectively. In this chapter, we have summarised feedback under relevant themes. Broader feedback not directly related to the consultation questions is not discussed in detail here; instead, our responses to those points are set out in the Issues Log published alongside this decision.

3.3 Respondents accept that both cost and outturn Net Regulatory Obligation (NRO) figures are to be reported at the programme level, consistent with the Network Annual Reporting Workbook (NARW) submission. They agree that the revised wording in the Handbook appropriately clarifies this requirement.

3.4 However, consistent with feedback from our July policy consultation, respondents reiterated that programme-level Unit Cost Reporting (UCR) is not directly comparable to network-level UCR. They emphasised the importance of a pragmatic and proportionate approach, noting that programmes meeting the criteria under sections 10.5 and 10.7 should not be automatically classified as "Clearly Identifiable" (CI).

3.5 Respondents also requested that updated guidance and templates be issued as soon as possible, given the fast-approaching close-out process.

Consultation Question 1: Do you agree that the draft NARM Handbook aligns with our amendments proposed under the document titled "Qualifying criteria for Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery under the NARM Mechanism"? Where you disagree, please clearly set out your reasoning and specify other considerations/factors we should take into account.

3.6 The consultation question sought stakeholder views on our proposals regarding whether the draft NARM Handbook aligns with the proposed amendments set out in our policy decision. The following paragraphs present the views received on each proposed amendment in turn, followed by our decision. For the purposes of this chapter, we have separated the proposals into two parts: the proposed UCR threshold and the additional amendments considered for the NARM Handbook.

The proposed UCR threshold

What we consulted on

3.7 We stated a UCR threshold of +/-5% is considered a suitable threshold to manage this risk within acceptable bounds, on the basis of current evidence available. Moreover, we proposed that we consider a symmetrical target was appropriate to limit the risks consistently in each direction, i.e. the threshold should be the same for both under and over deliveries.

Consultation responses

3.8 Most respondents accepted the introduction of a ±5% UCR threshold, either supporting it outright or not opposing its inclusion. It was generally acknowledged that the threshold could help ensure proportionality between delivery and cost, and that it aligns with our November policy decision.

3.9 Several respondents reiterated concerns previously expressed during our policy consultation stage about the potential implications of applying the threshold in practice. These included the risk of a significantly increased number of projects being classified as Clearly Identifiable, which could raise the regulatory burden due to the volume of assessments required. Stakeholders also highlighted that small deviations in programme delivery could breach the threshold, even where overall network performance remains within the deadband.

3.10 In light of these concerns, respondents emphasised the importance of a pragmatic and proportionate approach to implementation. Several suggested the introduction of a materiality filter to help ensure that the threshold does not result in disproportionate impacts or unnecessary regulatory intervention.

Our decision

3.11 Having considered stakeholder views, we have decided to proceed with the proposed UCR Thresholds of +/-5%. . We remain of the view that this low threshold is necessary to ensure that funding adjustments are reflective of actual work undertaken and associated costs incurred.

Additional considered amendments to the NARM Handbook

What we consulted on

3.12 We proposed several additional amendments to the NARM Handbook, which we considered necessary to support the effective implementation of the UCR thresholds and the broader functioning of the NARM Funding Adjustment and Penalty Mechanism.

Our decision

3.13 Having considered stakeholder feedback, we have decided to proceed with the proposed amendments as set out in the statutory consultation. We have provided clarification on the intent or practical implications of certain elements raised by respondents, which are addressed in the following paragraphs. In addition, we have made minor amendments to the Handbook to improve referencing and ensure consistency of wording. Please refer to the Issues Log, which outlines where these changes have been made.

Selection of projects for clearly identifiable mechanism

What we consulted on

3.14 The NARM Handbook provisions require the Authority to assess NRO, incurred costs or unspent allowances linked to projects, or programmes of work, which meet the CI criteria for over or under delivery. To do this, we will require data on outturn Network Risk Output and costs on a project-by-project basis at close-out, rather than only at a risk sub-category level. As such, we proposed updating the requirements in the NARM Handbook to specify that licensees will be required to report outturn Network Risk Output and costs on a project-by-project basis (or programme of work basis in the case of gas) in the NARM Closeout Report. This is crucial in enabling Ofgem to review all projects (or programmes of work) and determine which should be processed through the 'clearly identifiable' mechanism.

Consultation Response

3.15 Respondents generally acknowledged the clarification in paragraph 7.12 that outturn NROs and costs should be reported on a project-by-project basis for ET and a programme-by-programme basis for GD and GT. This was seen as consistent with existing reporting practices and the structure of the NARW submission.

3.16 Two respondents raised concerns about the implications of this approach. They emphasised that applying the low UCR threshold at the programme level without a materiality filter could result in a disproportionate number of programmes being flagged for assessment, increasing regulatory burden and uncertainty. Respondents reiterated the importance of a pragmatic and proportionate approach to project selection. They cautioned against automatic classification of programmes as Clearly Identifiable based solely on threshold breaches and called for further guidance on how selection criteria will be applied in practice.

3.17 Some responses highlighted the need for clearer guidance on how the selection process will operate across sectors, particularly in light of differences in reporting granularity and risk categorisation between ET, GD and GT.

Our decision

3.18 We have decided to proceed with updating the requirements in the NARM Handbook for licensees to report outturn Network Risk Output and costs on a project-by-project basis (or programme of work basis in the case of gas) in the NARM Closeout Report. We remain of the view that outturn NROs and costs should be provided on a project-by-project basis in the case of ET, and a programme-by-programme basis in the case of GD and GT, rather than being summarised at the risk sub-category level. To ensure that appropriate funding adjustments are made, it is important that Ofgem has visibility at this level so it can decide whether a given delivery element should be treated through the 'automatic' or 'clearly identifiable' mechanisms. Without outturn data being made available at this level, Ofgem would not have the necessary data to check whether licensees have nominated the correct projects/programmes of work for the 'clearly identifiable' mechanism (based on the defined criteria in Section 10 of the Handbook).

3.19 As clarified in our policy decision, CIOD/CIUD only applies to delivery elements that deviate from baseline NROs. If delivery is within the deadband, CIOD/CIUD does not apply. As previously set out in in our policy decision, and while we accept the low CI UCR threshold could potentially result in, projects or programmes of works, being consider for CIOD/CIUD, we remain of the view a lower CI threshold is needed to mitigate against non-cost reflective outcomes.

3.20 As discussed, during working group meetings, we intend to apply a materiality threshold to determine the level of justification required for projects that meet the criteria for CI delivery elements. We will seek views from licensees following the issuance of the necessary documentation, subsequent to our assessment of the year 4 RRP submissions. We will be supplying the necessary documents and templates in August 2025, including the RRP templates, guidance and narrative documents, and the data template We have decided to amend the October 2025 RRP template to allow licensees to provide early sight of potential CI projects. This will enable us to determine the appropriate level of justification required at close-out and ensure our assessment remains pragmatic and proportionate. Detailed justification will be expected only for projects exceeding the pre-determined materiality threshold.

3.21 We consider that the materiality threshold should be informed by, and proportionate to, the collective spread of CI projects proposed within each sector. Early visibility of potential CI projects is therefore important in establishing what we have referred to as a pragmatic approach, particularly given the evolution of the mechanism. While the ±5% UCR threshold is necessary to ensure cost-reflective funding adjustments, the CI mechanism does not automatically apply to all breaches. Each case will be reviewed against the qualifying criteria set out in the NARM Handbook. We will continue to work with licensees to ensure a pragmatic and proportionate close-out process.

3.22 We agree with respondents' comments on the importance of a pragmatic and proportionate approach to project selection. Ofgem will assess delivery elements against the qualifying criteria outlined in the NARM Handbook. As noted in paragraph 3.20, we will also establish a materiality threshold to guide the level of scrutiny required. While licensees may propose CI elements, final decisions rest with Ofgem as set out in the NARM Handbook, to ensure consistency and fairness across sectors. This approach is intended to avoid both under- and over-inclusion of projects within the CI mechanism.

3.23 We believe the updated NARM Handbook has clarified sector-specific reporting expectations as far as possible. Additional guidance will be provided as part of the close-out process. We will also work with Licensees on the necessary testing and development of the templates ahead of close-out. While reporting granularity varies across ET, GD, and GT, the selection process is designed to be consistent and transparent. We will continue to engage with stakeholders to ensure alignment and clarity throughout the close-out process.

Clarification to qualifying criteria for the clearly identifiable mechanism

What we consulted on

3.24 We proposed to amend the second qualifying criterion Clearly Identifiable Over-Delivery to ensure projects which achieve an NRO over-delivery through a reduction in the scope of a baseline project and fewer physical asset interventions, can still qualify for as Clearly Identifiable Over-Delivery. Specifically, we proposed adding text to clarify that this criterion will not apply in cases where the over-delivery is achieved because of a reduced technical specification for that project (i.e. only a subset of assets being added back to the network relative to what was determined in baseline).

Consultation responses

3.25 Respondents acknowledged the proposal and while there was general recognition of the intent behind the clarification, several respondents raised concerns about its practical application; cautioning that the revision to the second criterion could result in efficient projects being unnecessarily classified as CI, particularly where reductions in scope are minor or reflect legitimate delivery optimisation.

3.26 It was suggested that a materiality filter should be applied to avoid capturing projects with marginal scope reductions or minimal changes in asset interventions. Some responses highlighted the need for clearer guidance on how the revised criterion will be applied, including definitions of what constitutes a “reduction in scope” and how this will be assessed across different sectors. One respondent noted that the current drafting could lead to illogical outcomes, such as projects delivering the same or better risk outcomes with fewer interventions being penalised, contrary to the principles of efficiency and proportionality.

Our decision

3.27 While we note responses raising concerns that efficient projects could be unnecessarily classified as CI due to minor scope reductions, we have decided to proceed with amending the second qualifying criterion As noted above, the amendment is intended to apply only to specific cases where the final delivered assets or technical specification are a subset of those at baseline. Therefore, it does not mean that any deviation from scope will trigger CI classification

3.28 As discussed at paragraph 3.20, we intend to apply materiality threshold, as part of our commitment to a pragmatic approach, therefore projects with a minor scope reductions will not necessarily be subjected to the CI. We also note, the CI mechanism will only apply where the deviation is material and meets all qualifying criteria, avoiding capturing marginal changes that do not warrant bespoke funding adjustments.

Clarification on the CIOOD term and Justification for clearly identifiable delivery elements

What we consulted on

3.29 We proposed to modify the NARM Handbook to clarify, in all relevant places, that it is the over- or under-delivery element that must be separated out from the outturn Network Risk Output, for the purposes of the 'automatic' funding adjustment mechanism, rather than the full project (or programme of work) associated with the specific over- or under-delivery element.

3.30 We also proposed to clarify in the NARM Handbook that projects dealt with separately through the 'clearly identifiable' mechanism would still be subject to the same justification process as those projects processed through the 'automatic' funding adjustment mechanism.

Consultation Response

3.31 Respondents welcomed the clarification that the 'delivery element' refers to the portion of NRO that represents an under- or over-delivery relative to the BNRO, including the associated work and costs. This clarification was seen as helpful in aligning the Handbook with the intended methodology for assessing Clearly Identifiable Over- or Under-Delivery (CIOD/CIUD). Respondents agreed that the clarification aligns with the proposed amendments and provides a clearer basis for identifying CIOD/CIUD.

3.32 It was noted that this approach supports a more structured and transparent assessment process. Some responses highlighted the importance of ensuring that the definition of 'delivery element' is applied consistently across sectors and documentation. There were calls for the term to be formally defined in the Handbook and glossary to avoid ambiguity. Respondents requested additional detail on how the delivery element will be assessed in practice, including how associated work and costs will be attributed and evaluated. Adding this was particularly relevant for complex or multi-component projects.

Our decision

3.33 We have decided to proceed with the modifications to the NARM Handbook to clarify the 'delivery element' refers to the portion of NRO representing over- or under-delivery relative to BNRO, including the associated work completed (or not) and its costs. This element, not the entire project or programme, is what will be assessed through the CI Mechanism.

3.34 Over- or under-delivery is defined in terms of network risk output, not simply changes in volume. A change in volume only constitutes over- or under-delivery if it impacts network risk output, which is the basis of the NARM Mechanism.. As requested by respondents, please see the provided worked examples to companies in the finalised NARM Handbook.

Clarification on determining the justification percentage JUS

3.35 We proposed that weighting the justification percentage for each project (or programme of work) by its relative justified contribution to the NRO over- or under-delivery is the most practical way forward for now. This approach is consistent with the broader framework, and any non-cost-reflective funding adjustments that could arise through this approach will be limited by the +/-5% UCR threshold to qualify for the 'clearly identifiable' mechanism.

Consultation Response

3.36 Respondents generally welcomed the clarification that the JUS should be determined for each project or programme of work and weighted by its relative justified contribution to the NRO over- or under-delivery. This was seen as a step toward a more transparent and structured approach to assessing delivery performance. Respondents agreed that weighting the justification percentage by the relative contribution to NRO is a logical and fair approach. It was seen as consistent with the broader aim of aligning funding adjustments with actual risk outcomes.

3.37 Some respondents wanted more clarity on how the justification percentage (JUS) will be calculated, including requests for worked examples, formulae, and clarification on whether weighting should be based on risk contribution, cost, or another metric. It was noted that, without clear thresholds or criteria, there could be uncertainty during close-out assessments. Several respondents suggested that justification should only be required for material deviations beyond the deadband to ensure proportionality and reduce administrative burden.

Our decision

3.38 We have decided to proceed with that JUS will be calculated by weighting each project's justification percentage by its contribution to overall NRO deviation, not by cost or allowance. Justification will only be required where outturn NRO deviates beyond the deadband, excluding clearly identifiable elements. This ensures proportionality and avoids unnecessary burden. To enhance clarity, we have reworded paragraphs 7.12(h)(i) and (j) to break down this part of the delivery assessment process. We believe this approach balances transparency, consistency, and regulatory certainty, and we will continue to engage with stakeholders through close-out.

Funding across regulatory periods

Consultation responses

3.39 Some respondents restated their views of the treatment of projects that span regulatory periods, particularly where delays are due to factors outside the control of network companies. These included supply chain disruptions and the inherent complexity of delivering large-scale infrastructure projects. They noted that the current requirement for projects to be completed by the end of RIIO-2 creates challenges for projects that may overrun by a few months, despite being necessary and efficiently delivered.

3.40 One respondent highlighted that the absence of a formal rollover mechanism between RIIO-2 and RIIO-3 introduces uncertainty in recovering allowances for justified works. They argued that even where over-delivery is justified, funding would not be received until the end of the next price control period, creating prolonged financial uncertainty and potentially discouraging optimal investment decisions.

3.41 Another respondent proposed a structured approach to managing cross-period funding, including the re-profiling of allowances into RIIO-3 without increasing the overall funding envelope, safeguards to avoid double funding, and a fallback mechanism for unjustified delays. They called for these provisions to be formally incorporated into the NARM Handbook to provide clarity and assurance at close-out.

3.42 A third respondent suggested introducing a grace period following the end of RIIO-2 to allow for the completion of projects before the close-out report is submitted. They argued that this would reduce administrative burden and avoid penalising projects that are only marginally delayed.

3.43 Respondents asked for amendments to the guidance to mitigate the risk of significant funding adjustments for projects that are delayed by a short period but remain justified and in consumers' interests. One respondent proposed an alternative approach for funding projects across regulatory periods and provide proposed updates to the NARM Handbook which they believed facilitated this.

Our decision

3.44 Having considered the feedback received. We maintain our position as set out in our policy decision that the NARM Handbook already provides sufficient mechanisms to deal with over- or under-deliveries within a regulatory period. We have decided to proceed with our proposal that project delays should be treated in the same manner as other types of over- and under-delivery through the existing mechanisms available

3.45 We are committed to ensuring that all efficient and well-justified investments are appropriately recognised and not overlooked within, and across, regulatory frameworks. We expect companies to fully utilise existing mechanisms, which we consider sufficient to fund the vast majority of non-load interventions. The NARM mechanism and the treatment of projects spanning regulatory periods, our position is that these should be treated like any other form of over- or under-delivery and managed through the existing NARM framework. While we acknowledge TOs' concerns that some delays may result from factors beyond their control, we of the view, based on engagement with licensees, that these are expected to cause only minor delays, with full delivery of outputs still intended.

3.46 We would expect licensees to provide sufficient detail on the likelihood of such delays.. To address this, for NARM projects we are introducing a reporting mechanism into the RRP, starting in 2025, allowing TOs to flag specific projects at risk of delay. Any remaining gaps will be considered as part of the RIIO-ET2 closeout or through RIIO-ET3 mechanisms.

Updated worked examples

3.47 We updated Appendix 4 of the NARM Handbook with worked examples to help illustrate some of the main aspects relevant to the implementation of the NARM Funding Adjustment and Penalty Mechanism methodology.

Consultation responses

3.48 Respondents broadly welcomed the inclusion of updated worked examples in Appendix 4, recognising them as a useful tool to support consistent understanding and application of the NARM Funding Adjustment and Penalty Mechanism. The examples were seen as a helpful step toward improving transparency and illustrating how the methodology is intended to operate in practice.

3.49 Some respondents, noted what they viewed as inconsistencies in the examples, particularly where similar projects were treated differently without explanation. Leading to them raising questions about the transparency and fairness of the assessment process.

3.50 Some respondents highlighted the absence of step-by-step narrative to accompany the numerical examples. They requested clearer explanations of how figures are derived and how decisions are made within each scenario. It was also suggested that the examples should be provided in Excel format rather than PDF. As this would allow users to trace calculations, test assumptions, and better understand the interaction between inputs and output

Our decision

3.51 We welcome the broad support from respondents for the inclusion of updated worked examples in Appendix 4 and have decided to retain these.

3.52 The examples are intended to support consistent interpretation and application of the NARM Funding Adjustment and Penalty Mechanism by illustrating key aspects of the methodology. They are not definitive or prescriptive but demonstrate how the methodology may apply in practice. Not all projects that appear to meet the "clearly identifiable" criteria will necessarily be treated as such; some may require bespoke assessment based on context and evidence. Having carefully considered the feedback we received, we have addressed the specific points raised on the updated examples in the Issues Log. In addition, we are implementing a key amendment in response to stakeholder feedback. This amendment aims to resolve identified inconsistencies within the Handbook and to provide greater clarity on the operation of the funding mechanism and is detailed below.

Clarification of Defined Calculation term, CIX_OD

3.53 In response to feedback from respondents on the worked examples, we note an error in the definition of the calculation term CIX_OD, which appears twice in the NARM Handbook, once in Section E, and once in Section F, with different definitions. These should, in fact, be treated as two distinct defined calculation terms. This inconsistency has led to confusion among respondents regarding how to calculate the value of CIX_OD, which features in two calculations used to determine a licensee's Final Allowed Expenditure.

3.54 During the delivery assessment, the determined additionally incurred costs or unspent allowances associated with each project's full risk output that meet the specified criteria for, and are deemed by the Authority to be, Clearly Identifiable Over-Delivery or Clearly Identifiable Under-Delivery elements (CIX_OD), are excluded from the [UCR] assessment.

3.55 These elements are then subject to a bespoke assessment, where the final additional incurred costs or unspent allowances associated with each Over-Delivery or Under-Delivery element's Network Risk Output, meeting the specified criteria and deemed by the Authority to be CIOD or CIUD for a given Delivery Element, are determined. The Final Allowed Expenditure is then adjusted to reflect the justified costs or unspent allowances associated with these elements.

Modifications in response to feedback received

3.56 As a solution, we have renamed the term CIX_OD in Section F to CIX_FAC, as this aligns with the subscripts used for other terms defined in Section F. The CIX_OD term in Section E will also adopt a subscript consistent with the other terms in that section. This change ensures consistency in the definition of terms and aligns with the overview described in 'Section 5 of the NARM Handbook, NARM Funding Adjustment and Penalty Mechanism – Overview'.

3.57 To do this we have:

- Updated Formula 7 to change the term from CIX_OD_i,j to CIX_FAC_i,j;
- Included in the definition of CIX_FAC that it is determined from the CI assessment; and
- Included a new definition for CIX_FAC in the glossary, in two locations.

3.58 The following Formulas are affected by this amendment:

Formula 5 $NXP_{OAD} = NXP_{OR} - CIX_{OD}$

Formula 7 $NXP_{FAC} = \sum_{j=Sub\ Category}\left[\sum_{i=Delivery\ Element\ (DE)}\left[NRO_{FAC_{i,j}} \times UCR_{FAC_{i,j}}\right] + CIX_{FAC_{i,j}}\right]$

4. Next steps

4.1 Having carefully considered the consultation responses we have decided to proceed with the proposed changes to the NARM Handbook, as detailed in Section 3. These changes will take effect 56 days from the date of this decision, on **26 August 2025**.