Guidance

NARM RIIO-2 Closeout Methodology

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This document sets out our guidance on the methodology and reporting requirements we will use to assess Network Asset Risk Metric (NARM) performance at the end of the RIIO-2 price control period.

NARM links network company funding to the delivery of risk reduction through asset management activities. This guidance explains how the Authority will assess RIIO-2 NARM delivery at closeout, including delivery against baseline risk outputs, changes in risk outside companies' control, over-delivery and under-delivery, and any resulting funding adjustments or penalties. It also provides guidance on electricity and gas transmission projects that are delayed beyond RIIO-2 and continue into RIIO-3.

This guidance reflects the Authority's decisions following consultation on 22 May 2026. The consultation responses, our decisions and the changes made to the methodology are set out in the accompanying RIIO-2 NARM Closeout Methodology Decision.

Contents

1. Introduction

1.1 This guidance sets out the methodology the Authority will apply when assessing RIIO-2 Network Asset Risk Metric (NARM) delivery at closeout.

1.2 It should be read alongside:

- the RIIO-2 NARM Closeout Methodology Decision;
- the NARM Handbook;
- the relevant licence conditions;
- the NARM Regulatory Instructions and Guidance (RIGs); and
- associated reporting templates.

1.3 This document explains the assessment methodology, evidencing requirements, treatment of crossover projects, justification assessment process and Incentive Value Calculation.

2. Overview of the NARM Funding Adjustment and Penalty Mechanism

This section provides an overview of the NARM Funding Adjustment and Penalty Mechanism and explains how it will be applied at RIIO-2 closeout. It sets out how delivery is assessed against the BNRO, how funding adjustments are derived using pre-determined Unit Cost of Risk (UCR) values, and how Clearly Identifiable delivery elements are treated separately where appropriate. This section also explains the three main stages of the closeout assessment process: Delivery Assessment, Justification Assessment and Incentive Value Calculation, and how these stages interact to determine final allowed NARM expenditure and any applicable penalties.

Approach and principles for RIIO-2 NARM closeout

2.1 The RIIO-2 NARM closeout methodology is designed to assess delivery of network risk outputs and apply funding adjustments in a manner that is transparent, proportionate and aligned with the interests of current and future consumers.

2.2 The methodology is guided by a set of overarching principles that underpin both the assessment of delivery and the operation of the NARM Funding Adjustment and Penalty Mechanism. These principles are intended to ensure that the closeout process operates consistently with the objectives of NARM and supports efficient, risk-informed decision-making.

2.3 The methodology is based on the following principles:

- Consumer value and efficiency remain central. Licensees' asset management decisions should be made in the interests of current and future consumers, delivering efficient and risk-informed outcomes.
- Delivery is assessed against a clear and consistent baseline. Performance will be assessed against the Baseline Network Risk Output (BNRO), adjusted where appropriate for validated Non-Intervention Risk Changes, to ensure a like-for-like comparison with the Outturn Network Risk Output (ONRO).
- Licensees are incentivised to deliver agreed outputs. The framework provides appropriate incentives for licensees to deliver their agreed BNRO, including recognition of justified over-delivery through funding adjustments and the application of penalties where unjustified under-delivery occurs.
- Proportionate treatment of delivery variation is applied. Sector-specific Deadbands are used to distinguish between immaterial variation and material deviation, ensuring that only significant differences from baseline outputs are subject to detailed justification.
- Flexibility in delivery is maintained, with appropriate scrutiny. Licensees are not constrained to deliver exactly the same set of projects assumed at baseline, provided they can demonstrate that any deviation from BNRO is justified and continues to deliver value for consumers.

- Assessment is applied at an appropriate level of aggregation. Delivery performance is assessed at Risk Sub-Category level (or network level for GD), ensuring consistency with how outputs were originally established while allowing supporting evidence at project or programme level to explain performance drivers.
- Valuation approaches reflect the nature of delivery. The methodology distinguishes between delivery assessed through the standard Unit Cost of Risk approach and delivery elements that qualify as Clearly Identifiable, which may be subject to a bespoke valuation approach where appropriate.

2.4 These principles underpin the three-stage closeout process: Delivery Assessment, Justification Assessment and Incentive Value Calculation.

NARM Objectives

2.5 NARM was developed to enable network asset risk to be quantified in a consistent and transparent manner and to support risk-informed asset management decision-making. Within RIIO-2, NARM forms part of the framework through which network companies are held accountable for the delivery of funded risk reduction outputs.

2.6 The NARM Objectives are set out in Special Condition 9.2 of network companies' RIIO-2 licences and underpin the wider NARM framework. In summary, the objectives are intended to:

- support transparent and evidence-based asset management decisions;
- enable comparison of delivered outputs against baseline expectations;
- facilitate estimation of network risk and the benefits of asset interventions;
- support cost-benefit analysis and efficient investment decision-making;
- improve understanding of the drivers of risk over time;
- enable consistent comparison of risk across assets and networks; and
- support clear and transparent reporting to Ofgem and stakeholders.

NARM Funding Adjustment and Penalty Mechanism

2.7 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.

2.8 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.[1]

2.9 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.

Baseline Network Risk Output (BNRO)

2.10 The Baseline Network Risk Output (BNRO) represents the expected level of monetised network risk that a licensee is required to deliver by the end of the RIIO-2 price control period. It is derived from the licensee's agreed investment plan and reflects the risk reduction expected from funded asset interventions. BNRO serves as the benchmark against which actual delivery, measured as the Outturn Network Risk Output (ONRO), is assessed. It is expressed in monetised risk units and segmented by Risk Sub-Category for Electricity and Gas Transmission, while Gas Distribution uses a single network-level value.

2.11 Network companies' RIIO-2 business plans included a mix of investments—some delivering Monetised Risk Benefits (e.g. asset replacement/refurbishment) and others that do not (e.g. new or non-network assets). Ofgem assessed these proposals and allocated approved investments to one of three NARM Funding Categories: A1, which contributes to a company's BNRO and is subject to the NARM Funding Adjustment and Penalty Mechanism; A2, which is funded under separate mechanisms but may contribute to ONRO if the original funding case falls away; and A3, which is ring-fenced and excluded from ONRO.

2.12 For Electricity and Gas Transmission, A1 is further divided into seven and three Risk Sub-Categories respectively, each assessed independently. While automatic trading between sub-categories is not permitted, companies may justify over-delivery in one area by referencing under-delivery in another. In Gas Distribution, BNRO is set at the network level with no sub-categories, so the terms Risk Category and Risk Sub-Category are used interchangeably.

[1] Elements of over- and under-delivery on network risk output that qualify as 'clearly identifiable' ie specific, separable projects, schemes or programmes of work with quantifiable outputs and costs, 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. Please see the NARM handbook for the clearly idenfiable qualifying certeria.

Unit Cost of Risk (UCR)

2.13 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.

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

2.15 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.

Overview of how the Mechanism will be implemented at closeout

2.16 The process for implementing the NARM Funding Adjustment and Penalty Mechanism at RIIO-2 closeout can be separated into three main stages. These stages do not necessarily need to be distinct from each other. It may be possible for there to be some overlap in terms of stage timings and activities. The three stages are:

1. Delivery Assessment
2. Justification Assessment
3. Incentive Value Calculation

2.17 The precise approaches, that we will use to carry out our assessment under the NARM Funding Adjustment and Penalty Mechanism, including licensees' submission requirements and timeframes for implementation, are set out in each of the relevant sections below. This has been informed by the development work, learning, or issues identified during RIIO-2.[2]

Delivery Assessment

2.18 This involves comparison of the licensee's ONRO against its BNRO. In order to be able to make a like-for-like comparison between the ONRO and BNRO, it will likely

[2] https://www.ofgem.gov.uk/decision/narm-handbook-updates-threshold-justifying-clearly-identifiable-over-or-under-delivery-and-related-amendments

be necessary to 'normalise' the BNRO data to account for Non-Intervention Risk Changes, such as data cleansing, changes to the methodology, and slower or faster deterioration of assets.[3]

2.19 The licensee will be required to submit data to enable the Delivery Assessment in a format to be specified and issued under Standard Condition B15 (Regulatory Instructions and Guidance) for electricity transmission and under Standard Condition A40 (Regulatory Instructions and Guidance) for gas transmission and gas distribution.

2.20 The Delivery Assessment will result in a decision from Ofgem on the extent to which it considers the licensee has Over-Delivered or Under-Delivered, or whether it has delivered its baseline for each Risk Sub-Category.

Justification Assessment

2.21 The purpose of the Deadband around the BNRO is to determine whether justification is required for an Over-Delivery or Under-Delivery. For an Over-Delivery or Under-Delivery within the Deadband, no justification is required and it will be treated as 100% justified. For an Over-Delivery or Under-Delivery outside the Deadband, the licensee will be required to provide justification for the full amount of any Over-Delivery or Under-Delivery.

2.22 During this stage, Ofgem will consider the justification provided by the licensee for any Over-Delivery or Under-Delivery, as set out in section 5 of this document, along with the cost and other data that will be needed to calculate the value of any funding adjustments or penalties.

2.23 Ofgem will take a view on the proportion of Over-Delivery or Under-Delivery that has been justified, details of how this will be done are set out in section 5. If the licensee delivers within the Deadband for a particular Risk Sub-Category, then the delivery will be considered justified for these purposes. Guidance on justification requirements can be found in section 5 of this document.

2.24 The licensee will also identify the delivery elements (e.g. specific projects) that, in its view, can be considered as Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery. The Handbook sets out the criteria for Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery. Ofgem's decision on any elements to be treated as Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery will determine the valuation approach for the purpose of the Incentive Value Calculation.

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[3] Risk changes resulting from revision of the NARM Methodology are addressed through a rebasing exercise (see section 3) and therefore will not need to be addressed during the delivery assessment. Guidance on the application of Non-Intervention Risk Changes is provided in NARM Handbook

Incentive Value Calculation

2.25 In calculating the value of the incentive under the NARM Funding Adjustment and Penalty Mechanism, Ofgem proposes to:

1. Determine the licensee's final allowances to reflect the licensee's level of delivery relative to its BNRO as well as the associated cost of delivery. Ofgem will use two valuation approaches:
   a. Any delivery considered by Ofgem not to qualify as Clearly Identifiable Over-Delivery or Clearly Identifiable Under-Delivery will be assessed using a Unit Cost of Risk Benefit (UCR) approach. This assessment is carried out for each portion of delivery, i.e.,

      (a) Baseline (all cases)
      (b) Justified Under-Delivery (if relevant)
      (c) Unjustified Under-Delivery (if relevant)
      (d) Justified Over-Delivery (if relevant)
      (e) Unjustified Over-Delivery (has a value of zero)
   b. Any delivery considered to qualify as Clearly Identifiable Over-Delivery or Clearly Identifiable Under-Delivery will be subject to a bespoke assessment of the efficient cost based on consideration of the fundamental underlying project components. For an Under-Delivery element, the adjustment of BNRO (i.e. claw-back) will be valued equal to the assessed value of that specific element/project we made at RIIO-2 Final Determinations. This may also include addressing partial delivery of a specific element or project.

   These assessments will result in a final allowance for each Risk Sub-Category, which is calculated as follows:[4]

$$\begin{bmatrix} Final \\ Allowance^{*} \end{bmatrix} = \begin{bmatrix} UCR \ \times NRO \\ (For\ each\ portion\ of\ delivery) \end{bmatrix} + \begin{bmatrix} Adjustment\ for\ Clearly\ Identifiable \\ Over\ Delivery\ and\ Under\ Delivery \end{bmatrix}$$

2. Determine the value of any applicable penalty for Unjustified Under-Delivery. Any Unjustified Under-Delivery will be subject to a penalty. The penalty will be equal to 2.5% of the clawed back allowance associated with the Unjustified Under-Delivery.

2.26 Both the funding adjustment and penalty will be applied in the next price control through the Price Control Financial Model (PCFM).

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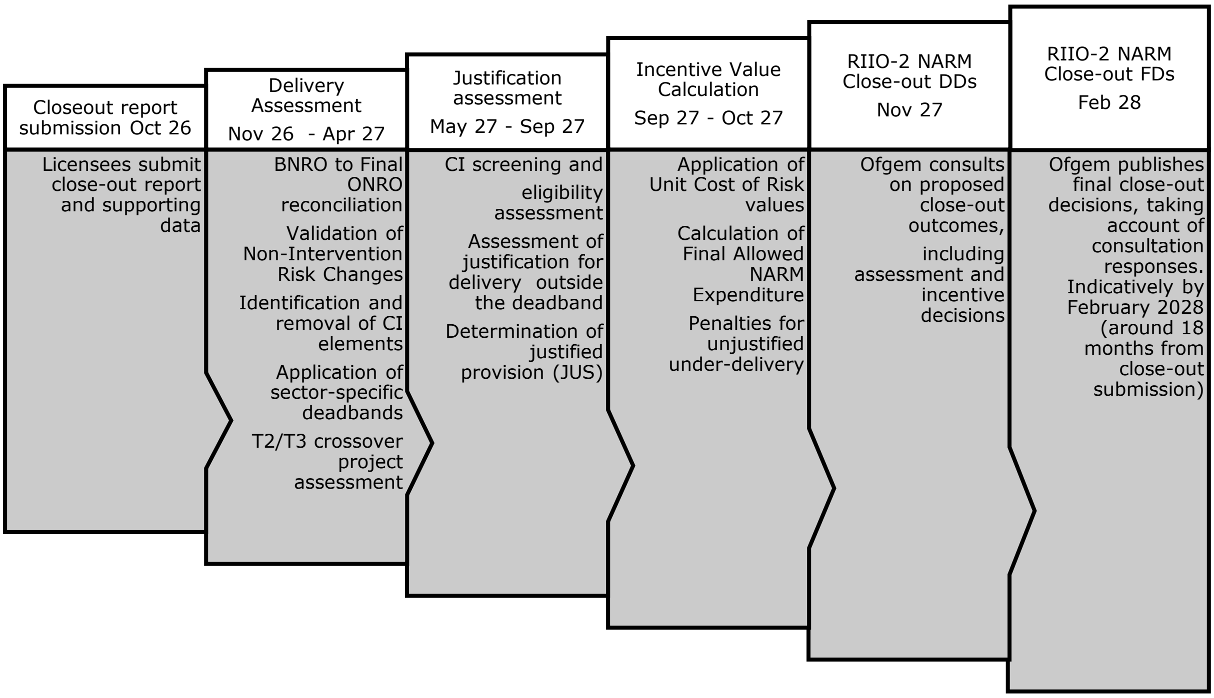
[4] The NRO in the formula refers to the Outturn Network Risk Output adjusted for Non-Intervention Risk changes and Clearly Identifiable Over-Delivery or Under-Delivery.

Timeline and submission requirements

2.27 The figure below illustrates the sequence of assessment stages following submission of the RIIO-2 NARM Closeout Report, leading to consultation on Draft Determinations and Final Determinations. Timings are indicative and remain subject to change.

Figure 1: Indicative RIIO-2 NARM Closeout timeline and assessment stages.



3. Delivery Assessment

This section sets out the process for assessing a licensee's delivery against its BNRO at the end of the RIIO-2 period. The aim is to determine whether the licensee has Over-Delivered, Under-Delivered, or delivered in line with expectations. To ensure a fair and like-for-like comparison, the assessment accounts for changes in risk not driven by licensee interventions (Non-Intervention Risk Changes) and separates out any Clearly Identifiable Over- or Under-Delivery elements. We will use the result of this assessment to determine whether the licensee's performance falls within the sector-specific Deadband, which in turn informs whether further justification is required.

3.1 As set out in the Handbook, Delivery Assessment is undertaken at Risk Sub-Category level (or, for Gas Distribution, at network level), consistent with the structure of BNRO and ONRO within the NARM framework. While licensees may present supporting evidence at project or programme level, this is to explain the drivers of performance rather than to define separate units of assessment.

3.2 To ensure that appropriate funding adjustments are made, it is important that Ofgem has visibility at the project or programme 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).

Preparatory steps for the Closeout process

CI threshold decision

3.3 As detailed in our earlier decision,[5] the NARM mechanism is working as intended and we therefore took the decision to set the CI threshold as 5%. While we accept the low CI UCR threshold could potentially result in projects or programmes of work being considered for CIOD/CIUD, compared to what was originally envisaged at FDs, we maintain confidence in our decision that a lower CI threshold is needed to mitigate against non-cost reflective outcomes.

[5] https://www.ofgem.gov.uk/decision/narm-handbook-updates-threshold-justifying-clearly-identifiable-over-or-under-delivery-and-related-amendments

Consideration of Year 4 RRP evidence and approach to CI materiality

3.4 As set out in our earlier decision on Clearly Identifiable Over-Delivery and Under-Delivery,[6] we indicated that we would consider the information submitted by licensees as part of their Year 4 Regulatory Reporting Pack (RRP) before providing any further guidance on how we would apply a pragmatic approach to CI outside of the immediate qualifying criteria. In particular, we signalled that this review would inform whether additional direction was required on the level of justification expected at close-out and on the potential benefits of fixing specific materiality thresholds.

3.5 On review of the Year 4 RRP data submitted by licensees, including the range, scale and distribution of projects that may potentially meet the CI qualifying threshold. In doing so, we considered whether the introduction of fixed or sector-specific materiality thresholds would improve the quality, consistency or proportionality of the projects proposed by licensees as Clearly Identifiable at close-out.

3.6 On balance, based on our review of the Year 4 RRP data, we do not consider that establishing definitive materiality thresholds would be appropriate. We do not consider there to be sufficient evidence that fixed thresholds would result in licensees providing a clearer or more effective view of the projects they propose for CI treatment. We also consider that the use of fixed thresholds could risk excluding relevant edge cases that may warrant CI consideration, given the diversity of project types, scales and risk impacts observed.

3.7 Instead, we consider that the guidance set out in this methodology, together with the CI qualifying criteria and evidencing requirements already established in the Handbook, provides sufficient clarity for licensees. We therefore consider that companies are able to identify projects or programmes of work that may warrant consideration as Clearly Identifiable at closeout.

3.8 We recognise that, following our decision to retain the 5% threshold for Clearly Identifiable Over-Delivery and Under-Delivery, a relatively large number of projects or programmes of work may meet the qualifying criteria set out in the Handbook. The Authority's expectation remains that licensees should first apply the qualifying criteria contained in the Handbook when determining whether a delivery element may be considered Clearly Identifiable.

3.9 The guiding principles set out below are not intended to replace, amend or create additional qualifying criteria. Rather, they are intended to assist licensees in exercising judgement when considering which delivery elements that meet the Handbook criteria warrant nomination and explanation as Clearly Identifiable at

[6] ibid

closeout. In particular, they recognise that some projects may meet the qualifying criteria primarily as a consequence of the operation of the 5% threshold, while others may represent more significant or distinct examples of delivery that are separable from wider programme delivery and therefore warrant greater focus and justification at closeout, supported by the following guiding principles:

- Mechanistic distortion: Licensees should consider whether leaving a delivery element within the automatic FAPM, by virtue of the Risk Sub-Category it falls into, would produce outcomes that are materially driven by mechanical features of the funding model rather than by delivery performance. Where a project's impact on funding arises primarily from its interaction with sub-category UCRs or the structure of the mechanism such that it risks producing disproportionate, non-cost-reflective adjustments or undermines the operability of the mechanism, the project may be appropriate for consideration as Clearly Identifiable
- Material contribution: CI nomination should be focused on projects that make a material contribution to overall over- or under-delivery within a Risk Sub-Category (or at network level where applicable), rather than marginal contributors.
- Attribution and separability: The delivery element should be clearly separable from wider delivery activity, with risk and cost impacts that can be robustly attributed to that specific project or programme.
- Proportionality: Licensees should consider whether CI treatment is proportionate to the scale and impact of the delivery element, having regard to the level of additional justification and assessment effort that CI treatment entails.
- Clarity of underlying drivers: CI proposals should be grounded in clear delivery-driven outcomes. Where changes in assessed risk arise from Non-Intervention Risk Changes or broader system effects, these should be treated in accordance with the NIRC provisions and not nominated for CI treatment.
- Clearly Identifiable Delivery: Screening, Qualification and Evidence Requirements. As part of the Justification Assessment, licensees may identify delivery elements that they consider to be Clearly Identifiable Over Delivery or Clearly Identifiable Under Delivery. These elements must meet the qualifying criteria set out in the Handbook and must be screened and evidenced in accordance with the requirements below.

3.10 We believe these principles support consistent and pragmatic identification of CI delivery elements at close-out alongside the formal qualifying criteria. They do not introduce additional tests or thresholds but provide a framework to help licensees exercise judgement in determining which projects warrant nomination as Clearly Identifiable.

3.11 For the avoidance of doubt, licensees should apply the CI qualifying criteria set out in the Handbook in the first instance when determining whether a delivery element may be considered Clearly Identifiable. Delivery elements that meet those criteria should then be assessed against the relevant screening requirements set out in this methodology. Where a delivery element is subsequently proposed as Clearly Identifiable, the licensee should provide justification and supporting evidence in accordance with the requirements of this methodology. The guiding principles set out above are intended to support this process and assist licensees in exercising judgement when determining which delivery elements warrant nomination and explanation as Clearly Identifiable at closeout.

Project status definitions

3.12 Based on our assessment of Year 4 RRP submissions, we identified inconsistencies in how project statuses were applied across companies. We have therefore decided to introduce standardised definitions and provide examples of when these should be used in the table below.

3.13 Project status classifications are intended to support consistent reporting and assessment at closeout. They do not determine funding adjustments, justification outcomes, CI eligibility or crossover treatment, all of which will be assessed separately in accordance with the methodology.

Table 1: Standardised Project Status Reporting Definitions (for RIIO-2 NARM Closeout)

Project Label	Definition	When to report	Optional Sub-Status / Notes
Delayed	A project that has started delivery activity in RIIO-2 but the project remains incomplete at closeout.	Use where one or more of the following apply: • Physical works, procurement, engineering design, or enabling works have started. • Some risk reduction may have been delivered, including where only part of the original project scope has been completed, but the scheme is not complete at RIIO-2 Closeout.	Use where delivery has begun but the scope has materially changed relative to baseline assumptions (e.g. change in intervention type, asset count, or technical solution) and is now expected to be delivered in RIIO-3.

Deferred	No material delivery has occurred in RIIO-2 and the project is proposed to continue into RIIO-3., subject to Ofgem's assessment and decision.	Use where one or more of the following apply: • Required outages, consents or access were not available within RIIO-2. • Delivery is delayed, but the intervention and intended risk reduction remain fundamentally required. • The scheme continues into RIIO-3 under the same or a revised scope.	Use where the baseline scope has changed prior to deferral to RIIO-3 (e.g. full replacement changed to partial refurbishment).
Delivered	A project that has been fully completed within RIIO-2, with the delivered risk reduction reflected in ONRO.	Use where both of the following apply: • All intended physical works within scope are complete and operational. • Delivered risk aligns with the intervention as reported at closeout.	Use where the final delivered solution does not differ materially from the baseline scope (e.g. part-delivery only or an alternative intervention approach).
Not Delivered (including Cancelled)	A project included in RIIO-T2 BNRO where no material delivery occurred in RIIO-2 and the scheme will not proceed in its baseline form in RIIO-3.	Use where one or more of the following apply: • The project has been cancelled, abandoned, superseded, or replaced by a fundamentally different programme. • No significant RIIO-T2 risk reduction has been delivered. • Baseline BNRO must be removed unless justified under CI rules (CIUD).	This status should trigger explicit consideration of CIUD treatment where BNRO was included at Final Determinations.

3.14 For the avoidance of doubt, project status classifications should reflect the position of the project at the point of closeout submission. Consistent with the approach set out in this methodology, projects completed after 31 March 2026 but before the closeout submission date should be reported as Delivered where the relevant delivery has been completed and the associated risk reduction can be evidenced. The project status definitions do not alter the Authority's assessment of delivered outputs at closeout.

Treatment of Non-Intervention Risk Changes

3.15 This summary is provided for ease of reference. Licensees should consult the Handbook directly for the full definitions, reporting expectations, eligibility requirements, reporting expectations and treatment methodology for Non-Intervention Risk Changes.[7]

Classification and Evidencing of Non-Intervention Risk Changes

3.16 As part of the Delivery Assessment, the Authority distinguishes between Non-Intervention Risk Changes that arise at the level of individual projects and those that arise at a broader asset category or network level. This distinction, together with clear evidencing requirements, is necessary to ensure that adjustments to the Baseline Network Risk Output and the Outturn Network Risk Output are applied consistently, transparently, and can be robustly validated at close-out.

3.17 The Consolidated Non-Intervention Risk Change Summary and Normalisation Log forms the primary record through which the Authority will validate the identification, classification, and application of Non-Intervention Risk Changes at close-out. Licensees must ensure that the log is complete, internally consistent, and reconcilable to the adjustments reflected in the Adjusted Baseline Network Risk Output and Adjusted Outturn Network Risk Output.

3.18 Where the application of a Non-Intervention Risk Change results in movements that may appear counter-intuitive, including increases in assessed risk, negative values, or reversals from previously reported trends, licensees must provide a clear explanation linking the observed movement to the underlying evidence and the corresponding entry in the Consolidated Non-Intervention Risk Change Summary and Normalisation Log. This explanation must demonstrate that the movement arises from non-intervention factors rather than delivery decisions.

3.19 The Authority will use the Consolidated Non-Intervention Risk Change Summary and Normalisation Log, together with the supporting evidence provided, to determine whether Non-Intervention Risk Changes are valid and whether they should be reflected in the close-out assessment. Non-Intervention Risk Changes

[7] Section 9 – Guidance on the treatment of Non-Intervention Risk Changes of the NARM Handbook v4.0.

that are not appropriately evidenced or cannot be clearly reconciled through the log will not be validated for the purposes of adjusting the Baseline Network Risk Output or Outturn Network Risk Output.

Project-level Non-Intervention Risk Changes

3.20 These are changes in assessed risk that arise from new or revised information specific to an individual asset or scheme, and which are not the result of the intervention itself. These may include, for example, updated condition information identified through inspection or survey, or asset faults discovered during the course of planned works that alter the assessed risk position independent of delivery choices.

3.21 Where such changes occur, they must be recorded as project-level Non-Intervention Risk Changes and reflected explicitly in the adjustment of the relevant project's baseline and outturn risk values. Licensees must provide clear supporting evidence demonstrating the nature of the change, the source of the information, and the resulting impact on assessed risk.

3.22 For the avoidance of doubt, changes in risk outputs or assumptions arising from revisions to the NARM Methodology are not treated as Non-Intervention Risk Changes. In line with the NARM Handbook (see in particular Chapter 4 on rebasing and Chapter 9.6 on Non-Intervention Risk Changes), such changes are addressed through rebasing of the BNRO to ensure comparability between BNRO and ONRO, rather than through NIRC normalisation as part of the Delivery Assessment.

Category level Non Intervention Risk Changes

3.23 Category-level Non-Intervention Risk Changes are changes in assessed risk that arise from factors affecting a broader asset group, risk sub-category or network, rather than an individual project. These may include changes to underlying risk modelling assumptions, systematic data cleansing exercises, or re-parameterisation of consequence or deterioration inputs applied consistently across an asset category.

3.24 Category-level Non-Intervention Risk Changes will be reflected through aggregate adjustments to the Baseline Network Risk Output at the relevant level and must be supported by clear documentation explaining the rationale for the change, the scope of assets affected, and the quantified impact on risk outputs.

3.25 To support effective validation and audit of Non Intervention Risk Changes, licensees must provide a Consolidated Non Intervention Risk Change Summary and Normalisation Log as part of their closeout submission. This log must, as a minimum:

- identify each Non-Intervention Risk Change applied during RIIO-2;
- state whether the change is project-level or category-level;

- describe the underlying driver of the change and the evidence source relied upon;
- quantify the impact of the change on Network Risk Output; and
- clearly link the change to the corresponding adjustment reflected in the Adjusted Baseline Network Risk Output and Adjusted Outturn Network Risk Output.

3.26 Licensees must apply this classification and evidencing approach consistently and ensure that Non Intervention Risk Changes are not conflated with delivery outcomes or with Clearly Identifiable Over Delivery or Under Delivery. Only validated and appropriately evidenced Non Intervention Risk Changes will be reflected in the calculation of the Adjusted Baseline Network Risk Output and the Adjusted Outturn Network Risk Output used for closeout assessment.

Licensees submission of Non-Intervention Risk Changes and Impacts

3.27 The BNRO was established using the best available asset risk data at the start of RIIO-2, reflecting the expected impact of licensees' funded interventions. However, over the course of the price control period, changes may occur that affect the measured risk position but are not the result of licensee interventions. These are referred to as Non-Intervention Risk Changes (NIRCs) and must be transparently reported and evidenced in the NARM Closeout Report and annual RIGs submissions.

3.28 As outlined in the NARM Handbook, Ofgem will normalise the BNRO to account for valid NIRCs, resulting in an Adjusted BNRO (NROBLAD). The ONRO must always reflect the latest available asset data. Examples of NIRCs include:

- Data cleansing (e.g. correcting asset records or condition scores)
- Note: excessive data cleansing beyond a 0.5% guide level may be subject to investigation
- Methodology changes that do not trigger formal rebasing
- Changes in consequence of failure (CoF), including:
    - (a) Fixed network parameters (no adjustment)
    - (b) Financial parameters (adjusted for neutrality)
    - (c) Indirect interventions (may retain benefit)
- Differences in asset deterioration rates compared to forecasts
- Pre-RIIO-2 true-ups or legacy adjustments
- Changes in the asset base not linked to funded interventions
- External factors covered by other regulatory mechanisms

3.29 These changes may increase or decrease the measured risk and could influence delivery outcomes. Ofgem will assess whether these changes are within the licensee's control and whether they should be excluded from the incentive assessment.

Ofgem Assessment of Non-Intervention Risk and Impacts

3.30 Ofgem will review the reported changes to determine whether they are valid and material. Where appropriate, Ofgem will adjust the BNRO to remove the effects of these changes before comparing it to the ONRO. This ensures that the assessment of delivery is based on a like-for-like comparison and that licensees are not held accountable for risk movements outside their control.

3.31 This review may involve engagement with the licensee through Supplementary Questions (SQs) to clarify the nature, source, and materiality of the reported changes. If SQ responses materially affect the interpretation of risk changes, licensees may be asked to resubmit relevant parts of their submission.

3.32 Only after this adjustment process is complete will Ofgem proceed to assess whether the adjusted ONRO falls within the sector-specific Deadband and whether further justification or valuation is required.

Establishing the Final Delivery Position for RIIO-2

3.33 Delivery performance will be assessed with reference to outcomes relating to the RIIO-2 period. Licensees are expected to reflect final delivery positions, including any projects completed or evidenced up to the point of closeout submission. Consistent with the project status guidance set out above, projects completed before the closeout submission date may be recognised as delivered where the relevant delivery and associated risk reduction can be evidenced.

3.34 For the avoidance of doubt, this does not imply an open-ended delivery period. The closeout process is intended to capture the final position for RIIO-2, i.e. projects that have been delivered at the point of closeout submission.[8] Delivery extending beyond this point may not be reflected in the assessment where it would not be reasonable or proportionate to do so.

Treatment of Clearly Identifiable Over-Delivery and Under-Delivery

3.35 As part of the Delivery Assessment, licensees are required to identify any delivery elements that they consider to be Clearly Identifiable Over-Delivery (CIOD) or Clearly Identifiable Under-Delivery (CIUD). Eligibility and justification of CI proposals are assessed through the CI Screening and Justification process set out in section 5 of this document. These are specific projects or programmes of work that are separable from the wider delivery programme and meet the qualifying criteria set out in Chapter 10 of the NARM Handbook.

3.36 For the avoidance of doubt, the identification of Clearly Identifiable elements does not alter the level at which delivery performance is assessed. Consistent with the NARM framework, delivery performance at closeout is assessed at Risk

[8] This reflects the Final Determinations position to allow project delivery to be finalised beyond 31 March 2026 up to the point of closeout submission, while maintaining a bounded closeout process.

Sub-Category level (or, for GD, at network level), with such elements contributing to those aggregated outcomes rather than being assessed separately.[9]

3.37 Before comparing ONRO to the Adjusted BNRO (NROBLAD), Ofgem removes any delivery elements that it determines to be Clearly Identifiable. This is done by subtracting the value of these elements (CIOOD) from the reported ONRO (NROOR), resulting in an adjusted ONRO (NROOAD). This ensures that the comparison reflects only the portion of delivery that is not subject to separate treatment, allowing for a fair and consistent assessment against the adjusted baseline.

3.38 The CIOD and CIUD elements are then assessed independently through a bespoke valuation process. Ofgem will determine whether each element meets the qualifying criteria and whether it is justified. Only those elements that are both clearly identifiable and justified will be included in the final funding calculation. Unjustified CIUD elements may also be subject to a penalty.

Comparison of ONRO to BNRO (ONRO vs. BNRO)

3.39 Once the ONRO has been adjusted to exclude any Clearly Identifiable delivery elements (i.e. NROOAD = NROOR – CIOOD), it is compared to the Adjusted BNRO (NROBLAD). This is the core quantitative step in the Delivery Assessment process, as set out in this document, this comparison determines whether the licensee has delivered more or less Network Risk Output than was expected at the outset of RIIO-2.

3.40 If the adjusted ONRO (NROOAD) is greater than the NROBLAD, this is classified as Over-Delivery. If it is lower, it is classified as Under-Delivery. The magnitude and direction of this difference inform whether the licensee’s performance falls within the sector-specific Deadband or requires further justification. This comparison is conducted independently for each Risk Sub-Category (or at the network level for GD), ensuring a consistent and transparent assessment of delivery across all sectors.

BNRO to Final ONRO Reconciliation

3.41 Once the ONRO has been adjusted to exclude any Clearly Identifiable delivery elements (i.e. NROOAD = NROOR – CIOOD), it is compared to the Adjusted BNRO (NROBLAD). This comparison is the core quantitative step in the Delivery Assessment process and determines whether the licensee has delivered more or less Network Risk Output than was expected at the outset of RIIO-2.

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[9] The criteria for Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery are set out in Chapter 10 of the NARM Handbook.

3.42 As part of this process, licensees must provide a clear and auditable reconciliation showing how the final Network Risk Output position used for RIIO-2 close-out has been derived from the BNRO.

3.43 This reconciliation must set out, in a transparent and sequential manner:

- the Baseline Network Risk Output (BNRO) as set at RIIO-2 Final Determinations;
- any adjustments to BNRO arising from validated Non-Intervention Risk Changes, resulting in an Adjusted BNRO; and
- the Final Outturn Network Risk Output (Final ONRO) following the removal of any delivery elements determined by the Authority to be Clearly Identifiable and therefore subject to separate treatment.

3.44 The purpose of this reconciliation is to ensure that the final delivery position assessed at close-out can be clearly traced back to the original BNRO, with each adjustment step explicitly identified, quantified, and supported by appropriate evidence.

3.45 Licensees must present this reconciliation at the level of granularity required to support the Delivery Assessment, including by Risk Sub-Category where applicable. The reconciliation must distinguish clearly between changes in risk attributable to delivery, changes attributable to Non-Intervention Risk Changes, and changes attributable to the identification and removal of Clearly Identifiable delivery elements.

3.46 Only the Final ONRO derived through this reconciliation will be used by the Authority for the purposes of applying the sector-specific Deadband, determining the extent of any Over-Delivery or Under-Delivery, and informing subsequent stages of the NARM Funding Adjustment and Penalty Mechanism.

Presentation of BNRO to Final ONRO Variance

3.47 Following completion of the BNRO to Final ONRO reconciliation, licensees must present the variance between the Adjusted BNRO and the Final ONRO in both:

- **absolute terms**, expressed as Network Risk Output (R£m); and
- **relative terms**, expressed as a percentage of the Adjusted BNRO.

3.48 This information must be provided for each relevant Risk Sub Category (or at network level where applicable) and must be consistent with the reconciled values used for the Delivery Assessment.

3.49 The presentation of variance in both absolute and percentage terms is required to support transparent application of the sector specific Deadband, to inform the assessment of the scale of any Over Delivery or Under Delivery, and to provide a clear evidential basis for subsequent stages of the NARM Funding Adjustment and Penalty Mechanism.

3.50 Only variances derived from the reconciled Final ONRO will be used by the Authority for the purposes of determining whether delivery falls within the Deadband, assessing justification, and calculating any funding adjustments or penalties.

Key Calculation Terms Used in the NARM Close-out Assessment

3.51 The Authority applies the NARM Funding Adjustment and Penalty Mechanism using the calculation terms and relationships set out in the NARM Handbook and the licence. For clarity, the key calculation terms referenced in this methodology are summarised below.

3.52 In the Delivery Assessment stage:

- NROBLAD (Adjusted Baseline Network Risk Output) represents the Baseline Network Risk Output adjusted to reflect validated Non-Intervention Risk Changes.
- NROOAD (Adjusted Outturn Network Risk Output) represents the Outturn Network Risk Output following the removal of any delivery elements determined by the Authority to be Clearly Identifiable and therefore subject to separate treatment.

3.53 The comparison between NROOAD and NROBLAD forms the basis for the Deadband test and the determination of Over Delivery or Under Delivery.

3.54 In the Incentive Value Calculation stage:

- UCRBLAD (Adjusted Baseline Unit Cost of Risk) represents the unit cost of delivering Network Risk Output, derived in line with the baseline outputs used for close-out assessment.
- UCROAD (Adjusted Outturn Unit Cost of Risk) represents the unit cost of delivering the Outturn Network Risk Output.
- NXPFAC (Final Allowed NARM Expenditure) represents the final allowed expenditure determined under the NARM Funding Adjustment and Penalty Mechanism, following application of justification decisions and any penalties for Unjustified Under-Delivery.

3.55 These calculation terms will be applied by the Authority in accordance with the NARM Handbook. This methodology does not amend the underlying calculation approach but sets out how the inputs to these calculations are derived and evidenced through the closeout assessment process.

Application of Deadbands

3.56 Once ONRO is compared to the adjusted BNRO (NROBLAD), the result is assessed against the sector-specific Deadband. The Deadband is a tolerance range applied to each Risk Sub-Category (or network level for GD). For RIIO-2, the

Deadband has been set at ±2% for ET and ±5% for GT and GD. If the ONRO falls within this range, the delivery is deemed to be within acceptable bounds and is automatically considered 100% justified. This means that no further justification is required from the licensee, and the full value of the delivery is recognised for the purposes of the NARM Funding Adjustment and Penalty Mechanism.

3.57 If the ONRO falls outside the Deadband, either above or below the NROBLAD, then the licensee must provide a justification for the full extent of the deviation. This justification is assessed by the Authority to determine the proportion of the over- or under-delivery that should be treated as justified. The outcome of this assessment directly informs the calculation of the licensee's final allowed expenditure and, in the case of unjustified under-delivery, the application of any penalties. The Deadband therefore acts as a threshold mechanism, ensuring that only material deviations from baseline expectations are subject to further scrutiny, while providing regulatory certainty for delivery within a reasonable range.

4. Treatment of RIIO-2 / RIIO-3 crossover projects

This section explains how the Authority will consider NARM projects that were included in RIIO-ET2 or RIIO-GT2 but are delivered later than originally expected and extend, in whole or in part, into RIIO-3. Such projects will first be assessed through the applicable RIIO-2 NARM closeout arrangements. Where appropriate, associated outputs, allowances and expenditure may subsequently be considered through the relevant sector-specific RIIO-3 licence mechanism.

For Electricity Transmission, the detailed guidance below applies to RIIO-ET2 NARM projects and the mechanisms established under SpC 3.10 and SpC 3.23 of the Electricity Transmission licence. For Gas Transmission, relevant RIIO-GT2 NARM projects may be considered through the GT2/GT3 crossover arrangements under SpC 3.28 of National Gas Transmission's licence, subject to the applicable licence requirements and GT2/GT3 crossover guidance.

This section does not create new policy and should be read alongside the closeout arrangements set out elsewhere in this methodology and the relevant provisions of the licence and the existing guidance on crossover projects.

Treatment of RIIO-ET2 NARM Projects Delayed into RIIO-ET3

4.1 This section applies only to electricity transmission licensees. It explains how the Authority will assess RIIO-ET2 NARM projects that remain incomplete at closeout and how, where appropriate, the remaining scope may subsequently be considered for delivery in RIIO-ET3.

4.2 There are two related stages:

- RIIO-ET2 closeout: the Authority will assess delivery achieved by the closeout submission date under the RIIO-ET2 NARM Funding Adjustment and Penalty Mechanism. Where funded outputs have not been delivered, this assessment may result in an adjustment to the RIIO-ET2 funding position.
- Potential RIIO-ET3 treatment: the Authority will consider whether the remaining project scope continues to provide consumer benefit and should be taken forward through an applicable RIIO-ET3 licence mechanism.

4.3 The Authority intends to present and consult on its provisional conclusions on both stages through the NARM Closeout Draft Determinations. The NARM Closeout Final Determinations will confirm the RIIO-ET2 delivery and funding position, the projects considered suitable for further consideration within RIIO-ET3, the relevant outputs and allowances, and the intended RIIO-ET3 licence route. Any subsequent allowance adjustment will be implemented in accordance with the applicable RIIO-ET3 licence process.

4.4 Before the Authority reaches its Final Determinations, identification of a project for potential RIIO-ET3 treatment does not guarantee that the project will receive an allowance or predetermine the amount or applicable licence route. The Authority's conclusions will follow assessment of the licensee's closeout submission and project-specific evidence against the relevant licence requirements.

4.5 The two stages are separate but connected. The RIIO-ET2 FAPM assessment will be completed first, but the Authority will take account of the available evidence concerning potential continued delivery in RIIO-ET3 when reaching its closeout conclusions. This will support a coherent view of each project and help ensure that any funding treatment appropriately reflects delivery achieved, efficient expenditure and remaining outputs, without duplicate funding.

4.6 This section provides guidance on the intended approach and should be read alongside the applicable licence conditions and existing guidance on crossover projects. It does not predetermine the treatment of any individual project.

Assessment at RIIO ET2 Closeout

4.7 All NARM projects included in RIIO-ET2 will be assessed at closeout in accordance with the final delivery position established under this methodology. Consistent with the approach set out in Section 3, this may include projects completed and evidenced up to the closeout submission date. Where a project remains undelivered at the closeout submission date, the Authority will assess that project through the RIIO-ET2 NARM FAPM.

4.8 Where an output has not been delivered by the closeout submission date, the Authority will assess the resulting under-delivery through the RIIO-ET2 NARM FAPM, including the justification and Clearly Identifiable assessment processes set out in Sections 3 and 5 of this methodology. This may result in a downward funding adjustment. The closeout assessment will reflect outputs delivered by the closeout submission date and will not take account of forecast delivery beyond that date. In undertaking the RIIO-ET2 FAPM assessment, the Authority will be cognisant of the potential for subsequent RIIO-ET3 treatment, but this will not alter the assessment of delivery achieved by the closeout submission date.

Consideration of Carry Over into RIIO ET3

4.9 Where the Authority considers that delivery of an incomplete RIIO-ET2 NARM project remains beneficial for consumers despite the delay, and delivery is expected to continue after completion of the RIIO-ET2 FAPM assessment, the Authority may subsequently consider whether the remaining outputs and any associated allowances should be taken forward into RIIO-ET3.

4.10 The purpose of the crossover arrangements is to provide a mechanism through which RIIO-ET2 funded outputs may continue to be delivered where this remains in the interests of consumers. The Authority is not seeking to reopen the original funding decision unnecessarily. Rather, the focus is on ensuring that efficient expenditure associated with funded outputs is treated appropriately where delivery extends beyond the RIIO-ET2 period.

4.11 In determining whether a project may be suitable for further consideration within RIIO-ET3, the Authority's starting point will be the project, outputs, scope and consumer benefits that formed the basis of the original RIIO-ET2 funding decision. The Authority will consider the extent to which the project proposed for carry-over remains consistent with the original funding decision, taking account of any changes that have occurred during delivery and any evidence provided by the licensee regarding the continuing delivery of consumer benefits.

4.12 Not all changes in scope, timing or delivery approach will prevent a project from being considered as a crossover project. The Authority recognises that projects may evolve for legitimate reasons during delivery. Where a licensee considers that a project remains an appropriate candidate for crossover treatment despite changes in scope, outputs, costs, delivery approach or timing, it should explain why those changes remain consistent with the original objectives and consumer benefits that formed the basis of the RIIO-ET2 funding decision. The Authority will consider this evidence as part of its assessment.

4.13 Consideration of potential RIIO-ET3 treatment does not alter the RIIO-ET2 closeout assessment. The RIIO-ET2 FAPM assessment will be completed first and will determine the delivery and funding position based on outputs delivered by the submission date. Following that assessment, eligible projects may be considered under the relevant RIIO-ET3 licence mechanisms. A delayed project may therefore be considered for implementation within RIIO-ET3 after the associated RIIO-ET2 under-delivery is assessed through the RIIO-ET2 closeout process. Equally, justified RIIO-ET2 under-delivery does not automatically mean that a project will receive an adjustment through a RIIO-ET3 mechanism.

Use of RIIO-ET3 Licence Mechanisms

4.14 Following completion of the RIIO-ET2 FAPM assessment, the Authority will determine which incomplete NARM projects it considers continue to deliver consumer benefit despite the delay and whether any associated allowances, outputs or delivery obligations require further consideration within RIIO-ET3. In reaching its RIIO-ET2 closeout conclusions, the Authority will have regard to the available evidence concerning the remaining project scope and potential continued delivery in RIIO-ET3.

4.15 The Authority’s starting point will be to consider whether Special Condition 3.10 provides the mechanism for a delayed RIIO-ET2 project. Where the Authority considers that Special Condition 3.10 in not applicable, it may consider whether another licence mechanism, including Special Condition 3.23, is appropriate. The Authority will set out its provisional view on the applicable licence route through the NARM Closeout Draft Determinations.

4.16 The purpose of the crossover process is to facilitate the continued delivery of RIIO-ET2 funded outputs where this remains in the interests of consumers. This guidance does not predetermine the outcome for any individual project, which will be determined following the Authority's assessment of the relevant evidence.

How the RIIO-ET3 route will be determined

4.17 Any proposed adjustment will be based on the Authority's assessment of the evidence submitted, including:

- the outputs delivered and expenditure incurred and recognised through RIIO-ET2 closeout;
- the remaining scope, outputs and delivery obligations;
- the extent to which the proposal remains consistent with the original funding decision;
- any material changes to scope, cost, timing or expected consumer benefit;
- the efficient expenditure required to complete the remaining outputs; and
- the need to prevent duplicate funding or recovery.

4.18 Following assessment of licensees' submissions, the Authority will set out its provisional conclusions on both matters through the NARM Closeout Draft Determinations. These will include the proposed RIIO-ET2 delivery and funding position, the projects considered suitable for further RIIO-ET3 treatment, the proposed licence route and, where applicable, any proposed RIIO-ET3 adjustment.

4.19 As set out in Section 2, the Authority will consult on its Draft Determinations, setting out its provisional conclusions on both the RIIO-ET2 closeout assessment and any proposed RIIO-ET3 treatment. Stakeholders, including licensees, will have an opportunity to respond before the Authority reaches its Final Determinations. Where appropriate, the Authority will implement any resulting RIIO-ET3 treatment in accordance with the applicable licence condition.

4.20 Nothing in this methodology predetermines the applicable licence route, guarantees recovery of expenditure or establishes an entitlement to an allowance under either RIIO-ET3 mechanism. Any RIIO-ET3 adjustment will remain subject to the relevant licence requirements and project-specific evidence.

Information Required to Assess Carry-Over Projects

4.21 To support the Authority's assessment of delayed or partially delivered NARM projects for the purposes of RIIO-ET2 closeout and potential consideration within RIIO-ET3, licensees will be required to provide additional information alongside their closeout submissions. This will include, as a minimum:

- Delivery status, clearly identifying which elements of the project have been completed by RIIO-ET2 closeout and which remain undelivered;

- Delivered Network Risk Output, quantified and evidenced in line with the NARM methodology;
- Remaining scope and outputs, identifying the elements proposed to be taken forward;
- Updated cost and allowance information, reconciled to the values underpinning the RIIO-ET2 funding decision;
- Revised delivery timelines for any undelivered outputs;
- Evidence of continued consumer benefit, demonstrating why delivery of the remaining outputs is still considered appropriate despite the delay; and
- A clear explanation of any changes in scope, outputs, costs, delivery approach or expected benefits relative to the original RIIO-ET2 funding decision.

4.22 Licensees should present information in a manner that enables the Authority to understand:

- what was originally approved and funded;
- what has been delivered and what remains to be delivered;
- what changes have occurred since the original funding decision; and
- why continued delivery remains consistent with the delivery of consumer value.

4.23 This information will be used by the Authority to:

- complete the RIIO-ET2 closeout assessment;
- determine whether further consideration within RIIO-ET3 is appropriate;
- determine whether the project proposed for carry-over remains sufficiently consistent with the original funding decision; and
- assess any subsequent application or assessment undertaken through the relevant RIIO-ET3 licence mechanisms.

4.24 Where a project remains consistent with the scope, outputs and consumer benefits underpinning the original RIIO-ET2 funding decision, the licensee may use the original funding submission and the costs and volumes underpinning that decision as the starting point for its closeout evidence. The licensee should update that information where necessary to reflect delivery achieved, expenditure incurred, remaining scope and the current delivery position.

4.25 In such circumstances, the Authority would not ordinarily expect to reassess the original funding decision from first principles or revisit costs previously allowed. Further assessment may, however, be required where there has been a material change to the project, including its scope, costs, outputs, delivery approach or expected consumer benefits, or where information arising through closeout indicates that further scrutiny is necessary.

4.26 Use of the original funding submission as a starting point does not predetermine the outcome of the Authority's assessment. Any adjustment will remain subject to the applicable licence requirements and consideration of delivery, efficient expenditure, continuing consumer benefit and the risk of duplicate funding.

5. Justification Assessment Process

This section sets out how we will assess and determine whether Over-Delivery or Under-Delivery outside the Deadband is justified. Delivery within the Deadband is treated as 100% justified and does not require further evidence. Where delivery falls outside the Deadband, licensees must provide evidence to support the extent to which the deviation should be recognised as justified. We will assess this evidence as part of the closeout process and use the outcome to inform final funding adjustments. This section also explains how we will assess justification for delivery elements that qualify as CIOD or CIUD. These elements are subject to a separate valuation approach, but must still be supported by appropriate evidence and justification.

Criteria for Justified Over-Delivery and Under-Delivery

5.1 Following completion of the Delivery Assessment, justification is applied to determine whether any identified deviations from the adjusted baseline position should be recognised.[10]

5.2 To be considered justified, the licensee must demonstrate that the deviation from the Adjusted BNRO (NROBLAD) was reasonable, necessary and in the interests of consumers. Justification is assessed at the Risk Sub-Category level (or network level for GD) and must be supported by evidence that the variation could not reasonably have been anticipated or avoided at the time of setting the RIIO-2 plan.[11]

5.3 Justification is required only when:

- The licensee's adjusted ONRO (NROOAD) falls outside the Deadband range around the adjusted BNRO (NROBLAD); and/or
- The licensee has identified Clearly Identifiable Over-Delivery or Under-Delivery (CIOD/CIUD) elements.

5.4 Delivery within the Deadband is automatically considered 100% justified and does not require further justification from the licensee for the purposes of the NARM Funding Adjustment and Penalty Mechanism.

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[10] While presented sequentially, the Delivery Assessment and Justification processes are not strictly linear and may operate iteratively in practice, with evidence and analysis refined as part of the overall closeout assessment.

[11] See NARM Handbook v4.0, Chapter 8, paragraph 8.3(b), which requires licensees to explain why the factors driving Over-Delivery or Under-Delivery could not reasonably have been forecast as part of the price control setting process and factored into the final NARM Workbook; and paragraph 8.4(d), which requires engineering justification papers to explain why the work that led to the Over-Delivery or Under-Delivery could not reasonably have been deferred or carried out.

CI Screening and Justification Pack

5.5 For each proposed Clearly Identifiable delivery element, licensees must complete a standardised CI Screening and Justification Pack. This pack must, as a minimum:

- identify the relevant project or programme of work;
- set out the associated Baseline Network Risk Output and Outturn Network Risk Output;
- present the Baseline and Outturn Unit Cost of Risk values;
- show the resulting Unit Cost of Risk deviation; and
- summarise the justification for CI treatment with clear reference to supporting evidence.

5.6 We have not prescribed a specific format for the CI Screening and Justification Pack. Licensees may therefore provide this information within their closeout narrative, supporting documentation, or a standalone submission, provided that all minimum information requirements set out in this section are included and can be clearly reconciled to the relevant workbook submissions and supporting evidence.

5.7 The CI Screening and Justification Pack provides the primary means by which the Authority will assess whether the qualifying criteria for CIOD or CIUD are met. This assessment relates to the eligibility and justification of specific elements and does not alter the level at which delivery performance is assessed, as set out in Section 3.

UCR Screening and Precision

5.8 An element may only qualify as Clearly Identifiable where the Outturn Unit Cost of Risk is either greater than 105% or less than 95% of the corresponding Baseline Unit Cost of Risk for the relevant Risk Sub-Category. Licensees must apply this screening test prior to proposing CI treatment.

5.9 To ensure consistent application of the UCR screening threshold, licensees must present Unit Cost of Risk values using sufficient decimal precision to avoid rounding effects that could incorrectly bring an element within or outside the ±5% threshold.

Interaction with Non-Intervention Risk Changes

5.10 Delivery elements will not qualify as Clearly Identifiable Over-Delivery or Under-Delivery where the underlying change in assessed risk is driven by a validated Non-Intervention Risk Change rather than by delivery choices.[12] Where risk movements associated with a project arise from Non-Intervention Risk

[12] Non-Intervention Risk Changes must be identified and validated in accordance with the Treatment of Non-Intervention Risk Changes section of this methodology.

Changes, these must be treated and evidenced in accordance with the NIRC provisions of this methodology and excluded from CI consideration.

Evidence Requirements

5.11 Licensees must provide proportionate supporting evidence for each proposed Clearly Identifiable delivery element. This evidence must demonstrate that:

- the delivery element is separable and attributable;
- the observed cost and risk outcomes arise from delivery decisions; and
- the CI qualifying criteria are met.

5.12 Evidence may include, where relevant, engineering assessments, asset condition information, cost records, outage documentation, or other contemporaneous material. Assertions that are not supported by evidence will not be accepted for CI treatment.

5.13 The Authority will assess all proposed Clearly Identifiable delivery elements in accordance with the NARM Handbook. Elements that fail to meet the qualifying criteria or evidencing requirements will be treated through the standard delivery assessment.

Required Justification Evidence

5.14 Licensees must ensure that all values, classifications and claims presented in the close-out narrative are consistent with the corresponding values submitted in the NARM close-out workbook. This includes, but is not limited to, Baseline and Outturn Network Risk Outputs, NIR Changes, CI delivery elements, UCR values and project status classifications.

5.15 Licensees must provide an explicit confirmation that the close-out narrative is consistent with the final submitted workbook. Where material inconsistencies are identified, the Authority may disregard the narrative position and rely on the workbook values for the purposes of the close-out assessment.

5.16 Where licensees provide supporting evidence to justify NIR Changes or CI delivery elements, this evidence must be presented in a structured and traceable manner. Licensees must provide a scheme-level evidence index that clearly links each item of evidence to the relevant project, adjustment or justification claim.

5.17 The evidence index must enable the Authority to readily identify, locate and review the material relied upon in support of close-out positions. Failure to provide a clear and complete evidence index may result in the Authority being unable to validate the relevant claim for the purposes of the close-out assessment.

5.18 The following evidence must be submitted as part of the licensee’s NARM Closeout Report to support any claim of justified Over-Delivery or Under-Delivery.

This should be read alongside the provisions of the NARM Handbook, which set out the full requirements.[13]

1. Quantification and Attribution
    - Identify the proportion of Over-/Under-Delivery considered justified
    - Attribute delivery to specific projects or drivers
2. Explanation of Forecasting Limitations
    - Why the deviation could not have been reasonably forecast at the time of Final Determinations
    - Examples: new safety regulations, asset faults, obsolescence, or external constraints
3. Early Notification
    - Evidence of early communication with Ofgem (e.g. via RRPs or correspondence)
4. Change in Intervention Plans
    - Clear explanation of how and why the delivery plan changed from the assumptions underpinning the original BNRO
    - Include deferrals, accelerations, substitutions, and cost impacts
5. Engineering Rationale
    - Explain the technical drivers behind the deviation, including changes in asset condition, obsolescence, or safety requirements
6. Cost-Benefit Analysis (CBA)
    - Provide a lifetime CBA comparing actual delivery to BNRO-aligned delivery
    - Demonstrate that the delivered outcome represents value for money
    - The analysis should:
      (1) Include direct and indirect benefits, including wider network impacts
      (2) Use consistent valuation assumptions (e.g. WACC, discount rates)
      (3) Reference relevant RIGs tables and NARM reporting data
      (4) Include sensitivity analysis to test key assumptions
7. Broader Impacts
    - Explain any interactions with other outputs, PCDs, or obligations
8. Stakeholder Engagement
    - Provide evidence of engagement with stakeholders (e.g. consumers, system operators, regulators)
    - Include consultation outcomes, safety reviews, or coordination with other programmes.

[13] NARM Handbook v4, Section 8

Ofgem's Evaluation Criteria

5.19 In addition to the evidence requirements set out above, we will assess the justification against the following overarching principles:

- Whether the delivered outcome provides better value for consumers than the original BNRO target.
- The internal consistency of any submitted CBA, including alignment between assumptions, inputs, and outputs.
- The presence of a credible alternative justification where a CBA is not feasible, such as legal, safety, or operational constraints.
- Evidence that the licensee has taken a balanced approach to risk across the network, considering the impact of delivery decisions on overall network performance and resilience.

Role of the JUS Percentage

5.20 We will assess the justification case and determine the proportion of Over- or Under-Delivery that is considered justified. This is expressed as the Justification Percentage (JUS). The JUS value is then used in the funding adjustment calculation to determine how much of the delivery is recognised for financial purposes.

If $NROOAD > NROBLAD$ (Over-Delivery), then:

$$\text{Justified Over-Delivery} = JUS \times (NROOAD - NROBLAD)$$

If $NROOAD < NROBLAD$ (Under-Delivery), then:

$$\text{Justified Under-Delivery} = JUS \times (NROBLAD - NROOAD)$$

6. Incentive Value Calculation

This section sets out how we will determine the Incentive Value Calculation. The Incentive Value Calculation is the final stage of the NARM Funding Adjustment and Penalty Mechanism. It determines the Final Allowed Expenditure (NXPFAC) for each licensee based on delivery performance relative to the BNRO, adjusted for Non-Intervention Risk Changes and Clearly Identifiable delivery elements. This stage also applies any penalties associated with the justification status of Over- or Under-Delivery and determines the final funding adjustments resulting from the closeout assessment.

Calculation Components

6.1 The incentive calculation comprises the following key components:

- Baseline Delivery: The portion of delivery that aligns with the adjusted BNRO (NROBLAD)
- Justified Over-/Under-Delivery: Delivery outside the Deadband that Ofgem deems justified
- Unjustified Over-/Under-Delivery: Delivery outside the Deadband that is not justified
- Clearly Identifiable Delivery: Projects assessed separately from the automatic UCR mechanism
- Associated Costs: Efficient costs linked to each delivery element
- Delivery Adjustment Factors (DAFs): Set to 0% for RIIO-2, meaning UCRs remain fixed at Final Determinations levels

6.2 Calculations are undertaken using the reconciled and assessed outputs determined in the Delivery and Justification Assessment sections.

Final Allowed Expenditure (NXPFAC)

6.3 The Final Allowed Expenditure is calculated using the following formula:

$$NXPFAC = \sum (NROFAC \times UCRFAC) + CIXFAC$$

- NROFAC: Final Network Risk Output for each delivery element
- UCRFAC: Final Unit Cost of Risk Benefit (fixed at UCRBLAD for RIIO-2)
- CIXFAC: Efficient costs for Clearly Identifiable Over-/Under-Delivery elements

6.4 This formulation brings together the delivery elements described in this methodology to determine the final allowed position, applying a consistent approach across baseline delivery and any justified or unjustified over- or under-delivery. In practical terms, the calculation adjusts the baseline expectation to reflect observed delivery performance, taking into account validated Non-Intervention Risk Changes and the treatment of Clearly Identifiable delivery elements. Full detail on the construction of each component, including the underlying formulae and parameter definitions, is set out in the NARM Handbook.

6.5 Each delivery element (baseline, justified/unjustified over-/under-delivery) is assessed separately using formulas set out in Table 4 of the Handbook, ensuring consistency with the BNRO and justification evidence. This includes:

- Baseline delivery
- Justified Over-Delivery
- Justified Under-Delivery
- Unjustified Over-Delivery
- Unjustified Under-Delivery

Penalty for Unjustified Under-Delivery

6.6 If a licensee has Unjustified Under-Delivery, a penalty is applied:

Penalty = 2.5% × (Unjustified Under-Delivery Value)

6.7 This penalty is applied to the clawed-back portion of the allowance and is added to the revenue adjustment in RIIO-3.

Treatment of Clearly Identifiable Delivery Elements

6.8 Where delivery elements are clearly identifiable and separable from risk-based outputs (e.g. specific asset replacements, safety-driven interventions), they are assessed under CIXFAC.