Making a positive difference for energy consumers

Supplementary annex 3

ED1 Price Control Financial Handbook

Section1

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Overview:

This is the ED1 Price Control Financial Handbook which forms part of Charge Restriction Condition 4A (Governance of ED1 Price Control Financial Instruments) of the Electricity Distribution Licence held by each electricity distribution network operator.

This document consists of:

a) a description of the ED1 Price Control Financial Model ('PCFM') and the Annual Iteration Process for it, used to update the licensee's Opening Base Revenue Allowances during the course of the RIIO-ED1 Price Control Period;

b) an overview of the ED1 Price Control Financial Methodologies under which revisions to the variable values in the PCFM are determined for the Annual Iteration Process, in accordance with the Charge Restriction Conditions of the Licence; and

c) a series of chapters containing the detailed methodologies relating to PCFM Variable Values.

The procedures relating to modification of this Handbook and the PCFM are contained in Charge Restriction Condition 4A.

An up to date version of this handbook and the PCFM (in Microsoft Excel® format) can be accessed on the Ofgem website.

Context

The RIIO-ED1 price control arrangements are the first, in respect of electricity distribution, to apply Ofgem's RIIO framework (Revenue = Incentives + Innovation + Outputs). The RIIO approach places more emphasis on incentivising network owners and managers to achieve the outputs needed to deliver sustainable energy networks at value for money for existing and future consumers.

The RIIO-ED1 price control is longer than the previous electricity distribution price control (known as DPCR5), running for eight years instead of five. This provides for a longer period of settled price control arrangements and should facilitate improved strategic planning and a long-term approach to electricity distribution infrastructure management.

The RIIO price control mechanisms are also more dynamic. Under the 'DPCR' price controls, base revenue allowances, typically representing over 80 per cent of network operation revenues, were set up-front for the whole of the price control period, changing only with RPI indexation. A number of significant adjustments to reflect activity levels and varying financial conditions were necessarily left in abeyance until the subsequent five-yearly review. Under RIIO-ED1, comprehensive adjustments to base revenue will be made each year in respect of the licensee's network business.

This more sophisticated approach involves an annual iteration of the ED1 Price Control Financial Model using updated variable values. This gives rise to a requirement for licence conditions and methodologies to govern the determination of revised PCFM Variable Values and the Annual Iteration Process.

This document, The ED1 Price Control Financial Handbook, which forms part of Charge Restriction Condition 4A, sets out the required processes and methodologies. To promote transparency, up-to-date copies of both the handbook and the PCFM will be maintained on the Ofgem website.

Associated documents

a. Strategy decision for the RIIO-ED1 electricity distribution price control

   http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=120&refer=Networks/ElecDist/PriceCntrls/riio-ed1/consultations

b. ED1 PCFM

   www.ofgem.gov.uk – search term "ED1 PCFM"

c. RIIO-ED1 Price Control Final Proposals/Determination

   [URL]

Contents

[Not included in this consultation:]

Introduction

The ED1 Price Control Financial Handbook ('the handbook') is one of the Price Control Financial Instruments referred to in Charge Restriction Condition 4A (Governance of Price Control Financial Instruments) of the Electricity Distribution Licence held by electricity distribution network operators. It describes the Price Control Financial Model ('PCFM') and the Annual Iteration Process for it, by which annual adjustments to the licensee's base revenues will be calculated. It also contains the Price Control Financial Methodologies ('the methodologies'), specified in relevant Charge Restriction Conditions, which will be used to determine appropriate revisions to the variable values contained in the PCFM to facilitate calculations under the Annual Iteration Process. The methodologies also describe the intent and effects of revising the various PCFM Variable Values.

This handbook, the constituent methodologies and the PCFM (together the Price Control Financial Instruments) form part of Charge Restriction Condition 4A. The Financial Instruments are subject to a formal change control process set out in that condition.

The PCFM Annual Iteration Process approach has been adopted because:

- it is consistent with the aims of the RIIO price control, embodying more 'real time' adjustments to financial allowances;
- it handles complex computational interactions between financial adjustments without the need for unwieldy algebra on the face of Charge Restriction Conditions;
- it provides for consistent treatment of the Totex[1] aspects of the price control;
- it maintains transparency on adjustments to base revenues, since the licence, methodologies, PCFM and variable values will be published; and
- it allows stakeholders to keep abreast of base revenue[2] levels and to carry out business sensitivity analysis.

In any case of conflict of meaning, the following order of precedence applies:

(i) the main text of the relevant licence condition(s),

(ii) the handbook and constituent methodologies, and

(iii) the PCFM.

[1] Total Expenditure – see Glossary

[2] The PCFM only calculates base revenue and the annual adjustment to Opening Base Revenue Allowances (the MOD term). It does not calculate the total allowed revenues of the licensee which includes additional components specified in Charge Restriction Condition 2A.

Terms used in this handbook

References to the Authority and Ofgem

The Gas and Electricity Markets Authority ("the Authority") is established by section 1 of and Schedule 1 to the Utilities Act 2000. The Office of the Gas and Electricity Markets Authority ("Ofgem") is the office that supports the Authority.

In this handbook the text refers to the Authority and Ofgem interchangeably.

Other terminology

Throughout this handbook:

(a) 'licence' means the particular Electricity Distribution Licence granted to the licensee under section 6(1)(c) of the Electricity Act 1989 in which the standard conditions contained in Section B (Additional Standard Conditions for Electricity Distributors who are Distribution Services Providers) are in effect ;

(b) 'licensee' means the holder of the particular licence as defined at (a) above;

(c) 'Charge Restriction Condition' means any one of the Charge Restriction Conditions contained in the licence as defined at (a) above;

(d) 'this handbook' means the ED1 Price Control Financial Handbook which forms part of Charge Restriction Condition 4A;

(e) 'Price Control Period' means the RIIO-ED1 price control period which runs from 1 April 2015 to 31 March 2023.

Where the meaning of other terms used in this handbook is not clear from the context, they will either be defined/explained in the chapter concerned or in the appended Glossary.

Section 1

1. The ED1 PCFM and the Annual Iteration Process

Overview

1.1 Charge Restriction Condition 2A (Restriction of Allowed Distribution Network Revenue) specifies the Opening Base Revenue Allowance[3] for the licensee for each Regulatory Year of the Price Control Period, reflecting the Authority's Final Determination for the RIIO-ED1 price control settlement.

1.2 The PCFM has been designed to calculate incremental changes to the licensee's Opening Base Revenue Allowance for each Regulatory Year so that the licensee's Base Demand Revenue reflects the adjustment schemes specified in the licence and detailed in the methodologies in this handbook. The adjustments fall into three broad categories:

- financial adjustments covering tax, pension and cost of debt issues;
- adjustments relating to actual and allowed total expenditure (Totex[4]) and the Totex Incentive Mechanism; and
- legacy price control adjustments – the close out of schemes and mechanisms from preceding price control periods.

1.3 The calculations take place under the Annual Iteration Process for the PCFM described below and are manifested as a PCFM output value for the term 'MOD' which is then applied as shown in the simplified[5] formula below:

Base Revenue for year t = Opening Base Revenue Allowance for year t + MOD for year t.

Price base

1.4 The PCFM works predominantly in a constant 2012/13 price base. This is consistent with the Opening Base Revenue Allowance values set down in the licence. The value of the term MOD is calculated in 2012/13 prices. Indexation is provided for in the formula set out in paragraph 2A.5 of Charge Restriction Condition 2A.

1.5 Some tax calculations internal to the PCFM use nominal prices, based on embedded RPI forecast data. The use of nominal prices in the PCFM tax calculations

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[3] Base revenue is the largest component of the licensee's overall allowed revenue but the other components, specified in the licence, should be taken into account in any assessment of total revenue allowances.

[4] See Glossary

[5] The full formula is shown in Charge Restriction Condition CRC2A, paragraph 2A.5

ensures that revenue allowance calculations more accurately reflect the profile of tax expenses of the licensee.

1.6 Where a methodology in this handbook calls for values to be deflated from a nominal price base, used in price control review information reporting, to the 2012-13 price base used in the PCFM, the following formula will be used:

$$\text{Value}_{\text{2012-13}} = \text{value}_{\text{nominal price year}} \times \frac{\text{RPI}_{\text{2012-13}}}{\text{RPI}_{\text{nominal price year}}}$$

where:

$\text{value}_{\text{2012-13}}$	means the deflated value in the 2012/13 price base;
$\text{value}_{\text{nominal price year}}$	means the value in nominal prices, used in price control review information reporting;
$\text{RPI}_{\text{2012-13}}$ `	means the arithmetic average of the Retail Prices Index (all items) figures published by the Office for National Statistics for each calendar month in Regulatory Year 2012/13 rounded to three decimal places; and
$\text{RPI}_{\text{nominal price year}}$	means the arithmetic average of the Retail Prices Index (all items) figures published by the Office for National Statistics for each calendar month in the Regulatory Year referred to in the price control review information in question rounded to three decimal places.

Temporal convention

1.7 The following conventions apply throughout this handbook.

Relative references

1.8 The MOD term is used to modify the licensee's Opening Base Revenue Allowance for each Regulatory Year t during the Price Control Period[6]. References in this handbook to Regulatory Years are made relative to that usage. For example, in a context where MOD_t applied in the formula for Base Demand Revenue in 2017/18, a reference in the same context to Regulatory Year t-1 would mean 2016/17 and so on.

Absolute references

1.9 A reference to, for example, 'the EDE value for 2017/18' means the EDE value in the 2017/18 column of the PCFM Variable Values Table for the licensee contained in the PCFM.

[6] In 2015-16, the first year of the Price Control Period, the licence specifies that the value of MOD is zero.

The PCFM and the Annual Iteration Process

1.10 The PCFM exists as a constituent part of Charge Restriction Condition 4A (Governance of ED1 Price Control Financial Instruments). It has an input area for the licensee containing both fixed values and a PCFM Variable Values table. The base revenue figure for the licensee for each Regulatory Year of the Price Control Period is calculated using the fixed values, the PCFM Variable Values, and the formulae and functions embedded in the PCFM.

1.11 At the outset of the Price Control Period, the base revenue figures calculated by the PCFM, using the variable values subsisting at that time, constitute the Opening Base Revenue Allowances for the licensee. Before the calculation of Opening Base Revenue Allowances was performed, Ofgem commissioned an external audit of the functionality of the PCFM and obtained an audit letter which has been published[7].

1.12 Subject to paragraph 1.13, by 30 November in each Regulatory Year t-1, or as soon as is reasonably practicable thereafter, Ofgem will determine whether any PCFM Variable Values for the licensee should be revised in accordance with the Charge Restriction Conditions and methodologies referred to in chapters 3 to 16 of this handbook.

1.13 The last Regulatory Year in which there will be an Annual Iteration Process for the PCFM is Regulatory Year 2021/22 for the purpose of determining the value of the term MOD for Regulatory Year 2022/23. Some financial adjustments provided for under the RIIO-ED1 Final Proposals will remain outstanding at the end of the Price Control Period, because relevant data will not be available in time for inclusion in the last Annual Iteration Process. For example, adjustments under the Totex Incentive Mechanism (see chapter 6) relating to actual and allowed expenditure levels in Relevant Years 2021/22 and 2022/23 will remain outstanding. For the avoidance of doubt, adjustments of this type will be addressed under the RIIO-ED2 price control arrangements.

1.14 In order to facilitate the determination of revised PCFM Variable Values by 30 November, Ofgem will normally expect to apply the following annual cut-off dates:

(a) 30 September in respect of functional changes to the PCFM; and

(b) 31 October in respect of information submitted by the licensee and used under the Price Control Financial Methodologies.

1.15 In applying the cut-off referred to in paragraph 1.14(b), Ofgem will, through business correspondence, apprise the licensee of any provisionality it has attached to information submissions, which might entail a restatement of the information by the

[7] [URL for audit letter on Ofgem website]

licensee for the purpose of making a further revision to the PCFM Variable Value(s) concerned for use in a subsequent Annual Iteration Process.

1.16 The Authority will give the licensee at least 14 days' notice of any revised PCFM Variable Values in accordance with requirements in the licence, to allow for any representations. The Authority will then (by 30 November in Regulatory Year t-1, or as soon as is reasonably practicable thereafter) specify any PCFM Variable Value revisions in a formal direction to the licensee. The direction will also include a copy of the PCFM Variable Values table for the licensee, showing the state of all variable values after the directed revisions, with revised values emboldened.

1.17 Having determined revisions to PCFM Variable Values for the licensee, Ofgem will carry out the Annual Iteration Process:

- revised PCFM Variable Values will be entered in the appropriate Regulatory Year column of the PCFM Variable Values Table for the licensee;
- the PCFM calculation functions will be rerun;
- all calculated values within the PCFM will be updated, including:
    - the recalculated base revenue figure for the licensee for each Regulatory Year of the Price Control Period, and
    - the modelled RAV balance for the licensee;
- the PCFM will output the value of MOD for Regulatory Year t for the licensee.

1.18 The output value of MOD_t for the licensee will reflect the difference between the recalculated base revenue figure for the licensee for Regulatory Year t (in the PCFM) and the Opening Base Revenue Allowance (PU term) set down in the licence. It will also reflect the difference between the recalculated base revenue figures held in the PCFM for Regulatory Years t-1 and earlier, before the Annual Iteration Process, and the recalculated base revenue figures for the licensee held in the PCFM for the same years after the Annual Iteration Process. The PCFM calculations will apply appropriate Time Value of Money Adjustments[8] to the calculation of MOD_t, so that the licensee will be in the same economic position as if adjustments to Base Demand Revenue for years prior to Regulatory Year t had been notified to it in the Regulatory Year concerned.

1.19 PCFM Variable Values for years later than Regulatory Year t do not feed into the calculation of the term MOD_t. Therefore, calculated values in the PCFM for Regulatory Years later than Regulatory Year t only represent a forecast. This is without prejudice to the status of the PCFM Variable Values concerned, which may have been determined and/or directed under licence conditions and which may or may not be subject to subsequent revision.

[8] see Glossary

1.20 Changes to base revenue figures calculated under the Annual Iteration Process may be upwards or downwards and, accordingly, the value of MOD_t may be positive or negative. A key point to note is that once the value of MOD has been directed for a particular Regulatory Year, it is not changed retroactively as a result of a subsequent Annual Iteration Process – the value becomes a matter of record alongside the Opening Base Revenue Allowance value for the same year.

1.21 The steps of the Annual Iteration Process are specified in Charge Restriction Condition 4B (Annual Iteration Process for the ED1 PCFM).

1.22 The Authority will issue a direction to the licensee giving the value of MOD_t by 30 November in each Regulatory Year t-1[9] or as soon as reasonably practicable thereafter. In practice, it is expected that the value of MOD_t will be included in the direction of revised PCFM Variable Values referred to in paragraph 1.16. The value of MOD_t in the direction will be stated in £m to one decimal place.

1.23 The deadline of 30 November in Regulatory Year t-1 for the direction of PCFM Variable Value revisions and for the value of MOD_t reflects

- the deadline of 31 July in Regulatory Year t-1 by which the licensee is required to submit most of its price control information returns (covering activity in Regulatory Year t-2) to Ofgem, and
- the need for the licensee to have confirmation of its Base Demand Revenue in time to calculate and issue its use of system charges.

1.24 In the unlikely event that the Authority does not direct a value for MOD_t by 30 November in Regulatory Year t-1, paragraphs 11 to 13 of Charge Restriction Condition 4B specify that:

- the Annual Iteration Process will stand uncompleted;
- the Authority will complete the Annual Iteration Process as soon as reasonably practicable by directing a value for MOD_t; and
- in the intervening period, the value of MOD_t shall be held to be equal to the value ascertained by:
    - taking a copy of the PCFM in its state following the last completed Annual Iteration Process (excluding the effect of any functional modifications under Charge Restriction Condition 4A made after the completion of that Annual Iteration Process);
    - using the selection facilities on the user interface sheet contained in that copy to select:
        - the name of the licensee; and

[9] The first such direction will be given by 30 November 2015.

- the Regulatory Year equating to Regulatory Year t; and

- recording the value of the term MOD_t for the licensee that is shown as an output value.

1.25 Table 1.1 below summarises the timings for the Annual Iteration Process during the Price Control Period.

Table 1.1 Summary of timings for the Annual Iteration Process

Annual Iteration Process					
AIP month	**PCFM Functional change cut-off**	**Regulatory reporting information cut-off**	**Proposed PCFM Variable Value revisions**	**AIP completed and MOD_t directed**	**Regulatory Year t in which MOD_t applies**
Nov-2015	30 Sep 15	31 Oct 15	15 Nov 15	30 Nov 15	**2016/17**
Nov-2016	30 Sep 16	31 Oct 16	15 Nov 16	30 Nov 16	**2017/18**
Nov-2017	30 Sep 17	31 Oct 17	15 Nov 17	30 Nov 17	**2018/19**
Nov-2018	30 Sep 18	31 Oct 18	15 Nov 18	30 Nov 18	**2019/20**
Nov-2019	30 Sep 19	31 Oct 19	15 Nov 19	30 Nov 19	**2020/21**
Nov-2020	30 Sep 20	31 Oct 20	15 Nov 20	30 Nov 20	**2021/22**
Nov-2021	30 Sep 21	31 Oct 21	15 Nov 21	30 Nov 21	**2022/23**

State of the ED1 Price Control Financial Model

1.26 As stated in paragraph 1.10, the PCFM exists as a constituent part of Charge Restriction Condition 4A and will be maintained by Ofgem in its official records. The state of the PCFM remains constant unless and until changed by either:

(a) an Annual Iteration Process - which will change PCFM Variable Values and recalculated values that are directly or indirectly dependent upon them; or

(b) a modification of the PCFM under the procedures set out in Charge Restriction Condition 4A.

1.27 Ofgem will keep a log of modifications to the PCFM and publish this log on its website.

1.28 A copy of the PCFM in its latest state will be maintained on the Ofgem website. This will allow the licensee and other stakeholders to make copies of the PCFM so that they can:

- use their own forecasts of PCFM Variable Value revisions to forecast base revenue positions and to conduct sensitivity analysis; and
- reproduce the calculation of MOD_t by 30 November in each Regulatory Year t-1.

The Annual Iteration Process is necessarily complex in some respects, but the PCFM is designed to be as 'user friendly' as possible.

1.29 Ofgem will upload an updated copy of the PCFM to its website by 30 November each year (after each Annual Iteration Process) with the electronic file name "ED1 PCFM November 20XX" (where 20XX represents the calendar year containing the month of November in Regulatory Year t-1).

Error of functionality in the PCFM

1.30 In the event that an error of functionality is discovered in the PCFM, the following procedure will be followed:

- the issue would be considered at the earliest opportunity by the ED1 PCFM Working Group (see next section) and a corrective modification proposed by Ofgem;
- if the functional error had distorted the calculation of a previously directed value of the term MOD, the determined modification would include any Time Value of Money adjustments necessary to correct for that distortion on an NPV neutral basis in the next calculation of the term MOD_t;
- the procedure in Charge Restriction Condition 4A for modifications to the PCFM would be followed.

The ED1 Price Control Financial Model Working Group

1.31 Ofgem will facilitate an industry expert working group to review issues arising with respect to the form or usage of the PCFM. The terms of reference for the ED1 PCFM Working Group ('the working group') are set out below.

1.32 In accordance with the provisions of Part A of Charge Restriction Condition 4A (Governance of ED1 Price Control Financial Instruments), the Authority will have regard to any views expressed by the working group when assessing whether any proposed modification of the PCFM would be likely to have a significant impact on the licensee or other stakeholders.

Terms of reference

Purposes of the working group

1.33 The purposes of the working group are:

(i) to review the ongoing effectiveness of the PCFM in producing a value for the term MOD for each Regulatory Year;

(ii) to provide, when requested by the Authority, its views to the Authority on the impact of any proposal (or prospective proposal) to modify the PCFM in accordance with Part A of Charge Restriction Condition 4A; and

(iii) to provide such views or recommendations to the Authority with regard to the PCFM as it sees fit.

Composition

1.34 The composition of the group will be:

- Ofgem (chair);
- Ofgem (secretary);
- one representative per licensee;
- Energy Networks Association representative (optional).

Timing and duration of the group's work

1.35 The working group's incumbency will run from 1 April 2015 to 31 March 2023.

1.36 The group will meet at least once between 1 January and 31 July during each calendar year, but may meet more frequently if required, in particular in relation to the provision of views on the impact of proposed PCFM modifications (see paragraph 1.33(ii)).

1.37 Representatives may attend meetings in person, or at the discretion of the chair, through video or telephone conferencing facilities.

1.38 A meeting of the working group will be quorate, for the purpose of expressing a view or recommendation in respect of the PCFM, when at least one representative from Ofgem, and at least three licensee representatives (each from a different ownership group) are present.

Resources

1.39 Meeting facilities will be provided or coordinated by Ofgem. Ofgem will keep notes of key points of discussion and views expressed at meetings, and of any recommendations made by the working group with respect to the PCFM.

2. The ED1 Price Control Financial Methodologies

2.1 The RIIO-ED1 Price Control Financial Methodologies set out in this handbook describe the basis for a range of annual adjustments to the licensee's Opening Base Revenue Allowances for the purposes of the RIIO-ED1 price control arrangements.

2.2 The main purpose of each methodology is to set out the way in which one or more PCFM Variable Values are to be revised as part of the Annual Iteration Process for the PCFM under which values of the term MOD_t are calculated (see chapter 1). Any revised PCFM Variable Values determined under the methodologies will replace (overwrite) the existing values contained in the PCFM Variable Values Table for the licensee in the PCFM as part of the Annual Iteration Process. The PCFM Variable Values table is on the Input worksheet of the PCFM and has been shaded blue for clarity; this area is informally known as 'the blue box'. Alongside each row of the blue box is a description of the item and the PCFM Variable Value name detailed in table 2.1 below.

2.3 The methodologies are presented in chapters 3 to 16 of this handbook, and are referenced in the associated Charge Restriction Conditions of the licence. As constituent parts of this handbook, the methodologies are part of Charge Restriction Condition 4A (Governance of ED1 Price Control Financial Instruments) and are subject to the modification provisions set out in that condition.

2.4 The methodologies are subordinate to the Charge Restriction Conditions of the licence. If there is any inconsistency between a licence condition and a methodology, then the licence condition takes precedence.

Methodologies in this handbook

2.5 The PCFM Variable Values to be determined under the methodologies in this handbook are listed in Table 2.1 below.

Table 2.1

PCFM Variable Value	Charge Restriction Condition	Description	Type of variable value
Specified financial adjustments			
EDE	CRC 3C	Pension Scheme Established Deficit	revenue adjustment
TTE		Tax liability – tax trigger events	revenue adjustment
TGIE		Tax liability – gearing/interest costs	revenue adjustment
CDE		Allowed percentage cost of debt	percentage
Totex Incentive Mechanism			
ALC	CRC 3B	Actual load-related capex expenditure	actual expenditure
ANLR		Actual non-load-related capex expenditure - asset replacement	actual expenditure
ANLO		Actual non-load-related capex - other	actual expenditure
AFE		Actual faults expenditure	actual expenditure
ARP		Actual 100% 'revenue pool' expenditure	actual expenditure
ACO		Actual controllable opex expenditure	actual expenditure
TRE		Actual tree cutting expenditure	actual expenditure
Allowed Totex expenditure adjustments			
UCEPS	CRC 3F	Uncertain costs – enhanced physical site security	allowed expenditure
UCSSW		Uncertain costs – specified street works	allowed expenditure
UCHVP		Uncertain costs – High value	allowed expenditure

		projects	
SMAE	CRC 3E	Smart metering roll out costs	allowed expenditure
LRRC	CRC 3G	Load related reopener costs	allowed expenditure
VAA	CRC 3J	Visual amenity costs	allowed expenditure
WSCC	CRC 3H	Worst served customer costs	allowed expenditure
IRM	CRC 3D	Innovation roll out mechanism	allowed expenditure
RE	CRC3K	Rail electrification[10]	Allowed expenditure
Legacy price control adjustments			
LTPG LTPS LTPD LTPC	CRC 3A	Legacy adjustments to opening tax pool balances	balance adjustment
RIRAV RIREV		RAV Rolling Incentive legacy price control adjustments	RAV balance adjustment revenue adjustment
OLRAV OLREV		Other legacy price control adjustments	RAV balance adjustment revenue adjustment

2.6 Specified financial adjustments relate to the adjustment mechanisms set out in the Strategy decision for the RIIO-ED1 electricity distribution price control - see associated document a. Overviews of the adjustments and the methodologies for determining revisions to the associated PCFM Variable Values are contained in chapters 3 to 5 of this handbook.

2.7 The Totex Incentive Mechanism applies to any overspend or under spend by the licensee against its RIIO-ED1 Totex expenditure allowances. An overview of the mechanism and the methodology for determining revisions to the associated PCFM Variable Values are contained in chapter 6 of this handbook.

[10] Applicable to WPD licensees only – see chapter 12A

2.8 Allowed Totex expenditure adjustments cover a range of Totex adjustment schemes under which allowed expenditure can be adjusted under a specified formula or through an application and assessment process. The methodologies for determining revisions to the associated PCFM Variable Values are contained in chapters 7 to 12A of this handbook.

2.9 Legacy price control adjustments relate to activities that took place in the price control periods prior to RIIO-ED1 (‘the legacy period’) but in respect of which a financial adjustment is required because:

- outturn data for Regulatory Year 2013/14 and/or 2014/15 were not available when Opening Base Revenue Allowances for the licensee were set;
- adjustment determinations for items subject to true-up, logging-up or reopener mechanisms were not complete when Opening Base Revenue Allowances for the Price Control Period were set; or
- there is an anomalous position, acknowledged by Ofgem and the licensee, that needs to be corrected.

The methodologies for determining revisions to the associated PCFM Variable Values are contained in chapters 14, 15 and 16 of this handbook.

Processing of different types of PCFM Variable Value under the Annual Iteration Process

2.10 In general terms, the different types of variable value specified in the fourth column of Table 2.1 are processed under the Annual Iteration Process for the PCFM in the following ways:

<u>Actual expenditure and allowed expenditure</u>

These variable values are used in Totex Incentive Mechanism calculations to determine the amounts that should, subject to the Totex Capitalisation Rate for the licensee, be processed as:

(a) fast money – flowing directly to the recalculated base revenue figure for the Regulatory Year to which the amount relates; and

(b) additions to the licensee’s RAV in the Regulatory Year to which the amount relates, generating a slow money adjustment to allowed revenues through the return on RAV and depreciation.

<u>Revenue adjustment</u>

These amounts flow directly to the recalculated base revenue figure for the Regulatory Year to which the adjustment circumstance relates (although there will also be ancillary financial effects under the modelling treatment). Revenue adjustments relating to Legacy price control adjustments are applied to Regulatory Year 2015/16, but are spread over the eight years of the Price Control Period by functionality in the PCFM to minimise any volatility impact.

<u>Allowed cost of debt percentage</u>

This type of variable value applies to the cost of corporate debt. As well as return on RAV, interest and tax calculations, corporate debt costs influence net present value calculations. Revised values for a particular Regulatory Year t will flow into calculations of the return on RAV.

<u>RAV balance adjustment</u>

This type of variable value relates to adjustments to qualifying expenditure during the price control period prior to RIIO-ED1. Revised values are input, as applicable, to the 2013/14 or 2014/15 columns of the PCFM. They generate an element of fast money applicable to regulatory Year 2015/16 and feed into slow money adjustments to base revenue recalculations through the return on RAV and depreciation.

<u>Tax pool balance adjustment</u>

This type of variable value relates to adjustments to the opening tax pool balances for the licensee to reflect outturn expenditure levels in the legacy period.

Consequential adjustments

2.11 During the Annual Iteration Process, appropriate automatic adjustments are also made as a consequence of revisions to PCFM Variable Values. For example, in some circumstances, as a result of automatic updates to the licensee's net debt and RAV figures under the Annual Iteration Process, updated equity issuance allowances could also be included in recalculated base revenue figures for the Regulatory Years concerned.

A typical revision

2.12 The ED1 Price Control Financial Methodologies describe the normal timing sequence for each PCFM Variable Value. For example, in relation to smart meter roll out costs, the normal sequence would be:

- activity takes place in Regulatory Year t-2;
- activity level reported to Ofgem by 31 July in Regulatory Year t-1;
- revised PCFM Variable Value (SMAE) used in Annual Iteration Process to take place by 30 November in Regulatory Year t-1 (the variable value in the column equating to Regulatory Year t-2 on the PCFM Variable Values Table is the one which is revised, since that is when the activity level took place);
- incremental change to recalculated revenue position for Regulatory Year t-2 flows through to value of MOD_t ie it affects base revenue in Regulatory Year t.

A number of the Charge Restriction Conditions provide for PCFM Variable Values to be directed for Regulatory Years outside the normal sequence. Where this is the case, the procedures are explained in the relevant methodologies in this handbook.

3. Pension scheme Established Deficit repair allowances - financial adjustment methodologies

Part 1 - Overview

3.1 The Opening Base Revenue Allowances ('PU' values) for the licensee set down in the table at Appendix 1 to Charge Restriction Condition 2A (Restriction of Allowed Distribution Network Revenue) include allowances for Pension Scheme Established Deficit repair expenditure for each Regulatory Year of the Price Control Period[11].

3.2 These allowances are represented by the opening EDE values[12] held in the PCFM Variable Values Table for the licensee contained in the PCFM and are expressed in 2012/13 prices. Opening EDE values are based on modelling assumptions and parameters applicable at the outset of the Price Control Period, consistent with Ofgem's pension principles (see paragraph 3.5 below).

3.3 The allowance levels will be updated during the Price Control Period by revising EDE values for the purposes of the Annual Iteration Process for the PCFM. This chapter sets out:

- the reasons for updating allowances;
- the methodologies for determining revised EDE values;
- the expected timing of revisions; and
- the effect on the licensee's allowed revenue of revising EDE values for the Annual Iteration Process.

3.4 In the context of Pension Scheme Established Deficit repair expenditure we refer to 'allowances' rather than 'allowed expenditure'. This is because, subject to the reasonableness tests referred to in this chapter, EDE values are included in full to recalculated base revenue figures in the PCFM under the Annual Iteration Process (ie these values are treated as 100% Fast Money). It should be noted, however, that revisions to EDE values will have ancillary effects on other calculations under the Annual Iteration Process which also feed into recalculated base revenue figures.

Price control pension principles

3.5 Ofgem's price control pension principles were set out in Appendix 7 of the Financial Issues paper which formed part of the March 2013 decision on strategy for the RIIO-ED1 price control (see associated document 'a') to which reference should be made. They include the following key points:

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[11] Pension scheme administration and Pension Protection Fund (PPF) levy costs are, together with ongoing pension costs, included as an element of labour costs in RIIO-ED1

[12] as at 1 April 2015

- customers should expect to fund the efficient cost of providing a competitive employment package including pension costs in line with comparative benchmarks;
- customers should only fund the portion (of a wider group's pension costs) that is attributable to the distribution business;
- customers should not fund pension costs arising from a material failure of stewardship;
- pension costs should be assessed using actuarial methods, on the basis of reasonable assumptions in line with current best practice;
- under or over funding positions in preceding price control periods should be reflected in allowances, subject to being economic and efficient; and
- customers should not fund the provision of enhanced pension benefits granted under severance arrangements which have not been matched by increased contributions.

Pension Scheme Established Deficit

3.6 For the purposes of Charge Restriction Condition 3C (Specified financial adjustments) and this chapter, the term Pension Scheme Established Deficit ('Established Deficit') means the difference between the assets and corresponding liabilities within a defined benefit pension scheme (or schemes), sponsored by the licensee, that are:

- attributable to the licensee's distribution business; and
- attributable to pensionable service up to and including 31 March 2010 (the cut-off date).

3.7 Ofgem will determine the licensee's Established Deficit using:

(i) the triennial actuarial valuation of the pension scheme or schemes that contain the Established Deficit described in paragraph 3.6;

(ii) the allocation of assets and liabilities in the scheme(s) referred to in sub-paragraph (i) to the Established Deficit using the deficit allocation methodology published by Ofgem in the Pension RIGs[13]; and

[13] Energy Network Operators' Price Control Pension Costs - Regulatory Instructions and Guidance: Triennial Pension Reporting Pack supplement including pension deficit allocation methodology ("Pension RIGs")

http://www.ofgem.gov.uk/Networks/Documents1/NWO%20Triennial%20Pension%20RIGS%20supplements%20v1.0%2012Apr13.pdf

(iii) a reasonableness review by Ofgem with respect to the price control pension principles which could result in adjustments to the Established Deficit figure.

3.8 Allowances for Established Deficit repair are set at/revised to levels intended to allow the licensee to clear its Established Deficit (by making payments to pension scheme trustees) over a 15 year period, which began on 1 April 2010 (immediately following the cut-off date) and ends on 31 March 2025. Under the price control pension principles, if the Established Deficit increases materially in the latter part of the 15-year period, the funding period may be extended, subject to consultation, at the Authority's discretion in order to appropriately share the burden of costs between different generations of consumers.

3.9 The setting of Established deficit repair allowances will also take account of a true-up relating to the licensee's actual Established Deficit funding payments compared to its allowances for the DPCR5 price control, as specified in paragraph 1.15 sub-paragraph (iv) of appendix 6 of the Strategy decision for the RIIO-ED1 electricity distribution price control (see associated document a.). Any adjustment will be informed by the reasonableness review regime referred to in paragraph 3.7. Adjustments relating to Regulatory Years 2010/11, 2011/12 and 2012/13 will be informed by the 2014 reasonableness review, and the adjustments relating to Regulatory Years 2013/14 and 2014/5, will be informed by the 2017 reasonableness review which is incorporated in the process set out in table 3.2. Licensees will be notified of any proposed adjustment and have the opportunity to respond.

3.10 The Price Control Period ends on 31 March 2023, but EDE values will be determined having regard to the projected Established Deficit repair completion date of 31 March 2025.

Costs and adjustments outside the scope of this chapter

Pension costs for service after 31 March 2010

3.11 Pension costs and accrued liabilities attributable to pensionable service after the cut-off date ('ongoing service costs') are treated as a component of labour costs within Totex and do not flow through to the Established Deficit. For the RIIO-ED1 Price Control Period, ongoing service costs include all pension scheme administration costs and Pension Protection Fund levy costs. These costs therefore fall outside the scope of Charge Restriction Condition 3C and this chapter.

True-up for pension payments by the licensee in the DPCR5 price control period

3.12 Under the terms of the price control that preceded the RIIO-ED1 Price Control Period (the DPCR5 price control), the licensee is entitled to a true-up amount derived using the difference between the level of pension costs included in its DPCR5 revenue allowances and the actual payments made by the licensee to the pension scheme. Any outstanding adjustment in respect of this true-up in relation to outturn expenditure levels for Regulatory years 2013/14 and 2014/15 will be applied in accordance with the legacy price control adjustment set out in part 1 of chapter 16. The true-up amount was included in Opening Base Revenue Allowances for the Price

Control Period, but forecast payment levels had to be used in respect of Regulatory Years 2013/14 and 2014/15. A further true-up to outturn payment levels for these years will therefore be required and this is addressed by the pension true-up legacy adjustment referred to in part 1 of chapter 16.

Part 2 - Updating Established Deficit repair allowances through the Annual Iteration Process

3.13 The licensee's allowances for Established Deficit repair costs will be updated during the Price Control Period to reflect:

- information contained in pension scheme actuarial valuation reports provided by the licensee to Ofgem;
- the updated Established Deficit determined in accordance with paragraph 3.7; and
- actual deficit funding payment information contained in the licensee's price control review information submitted to Ofgem.

3.14 Charge Restriction Condition 3C requires the Authority to determine annually whether any EDE values should be revised. However, the intention is that the values will actually be revised on three occasions during the Price Control Period, driven by the triennial scheme valuation cycle indicated in the timetable in Table 3.1 below. It might be necessary to revise EDE values at a different time if, for example, a scheme valuation or reasonableness review is unavoidably delayed.

Table 3.1 - Expected timetable for EDE value revisions

Actuarialy defined benefit pension scheme valuation as at	Expected receipt of scheme valuation by Ofgem	Pension deficit allocation methodology information provided	Reasonableness review completed	Revised EDE values directed for Annual Iteration Process no later than:	EDE values revised for Regulatory Year
31 March 2013	7 July 2014	30 September 2014	31 October 2014	30 November 2014	2015/16 onwards
31 March 2016	7 July 2017	30 September 2017	31 October 2017	30 November 2017	2018/19 onwards
31 March 2019	7 July 2020	30 September 2020	31 October 2020	30 November 2020	2021/22 onwards
31 March 2022	7 July 2023	30 September 2023	31 October 2023	see note	see note

Note: The reasonableness review of the valuations as at 31 March 2022 will inform the reset and true-up in RIIO-ED2 for regulatory year 2024/25 .

3.15 Licensees whose scheme triennial valuation dates differ to those shown in the first column of Table 3.1 will be required to provide either a full valuation (provided it is also used to determine the scheme's deficit recovery plan) or an updated valuation at these dates. The approach that should be used by the licensee to produce an updated valuation is set out in Ofgem's pension deficit allocation methodology.

3.16 Ofgem will direct revised EDE values at other times, if that is necessary to reflect any revised timetable of information availability or process completion. However, in those circumstances, EDE values would still be determined in accordance with the procedures set out in this chapter.

3.17 As set out in paragraph 3.4, revised EDE values feed directly into the recalculated base revenue figures in the PCFM for applicable Regulatory Years through the Annual Iteration Process. Incremental changes to recalculated base revenue figures for years earlier than Regulatory Year t will, subject to a Time Value of Money Adjustment, be brought forward and reflected in the calculation of the term MOD to be directed for Regulatory Year t. For the avoidance of doubt, such a revision will not have any retrospective effect on a previously directed value of the term MOD.

Reasonableness review

3.18 After receiving the whole (or substantially the whole) of the licensee's scheme valuation data set, Ofgem will commission a review of the valuation and of the reasonableness of the licensee's Established Deficit funding levels. The reasonableness review is referred to at paragraph 5(b) of Charge Restriction Condition 3C. The review will assist Ofgem in determining whether a licensee's pension costs are efficient. The expected completion times for the reasonableness reviews due to take place during the Price Control Period are shown in Table 3.1. The valuation data set comprises:

- the actuarial valuation of each defined-benefit scheme in respect of which the licensee is a sponsoring employer, being either a full valuation as at the dates specified in Table 3.1 (ie 31 March 2016, 2019 and 2022) or an update of the last preceding full triennial valuation, with the asset and liability values projected forward to the above date(s) on the basis set out in the pensions deficit allocation methodology document;
- each scheme's statement of funding principles;
- each scheme's statement of investment principles;
- the completed deficit allocation methodology tables and other pension data tables and supporting documents specified in the RIIO-ED1 RIGs; and
- any other information required for the purposes of a triennial review.

Part 3 – Established Deficit repair allowances

Determination and direction of revised EDE values by 30 November 2017

3.19 Subject to paragraph 3.21, revised EDE values will be determined by 30 November 2017 for each Regulatory Year from 2018/19 to 2022/23 using the methodology set out in Table 3.2 below.

Table 3.2 - Process for determining revised EDE values to be directed by 30 November 2017

Row	Timing	Event	Value
1	By 7 July 2017	Ofgem obtains the actuarial scheme valuation (on the basis set out in paragraph 3.17) for the licensee's defined benefit pension scheme as at 31 March 2016, together with scheme datasets, and commences a reasonableness review of all network operators' valuations as at 31 March 2016.	
2	By 31 July	Ofgem receives price control review information from the licensee covering Regulatory Years 2013/14, 2014/15,	

	2017	2015/16 and 2016/17.	
3	By 30 September 2017	Licensee submits deficit allocation information and indicative Pension Scheme Established Deficit figure relating to service up to 31 March 2010 as at 31 March 2016 and the movements from 1 April 2013 to 31 March 2016 in accordance with the deficit allocation methodology.	
4	By 31 October 2017	a) Ofgem carries out a reasonableness review of information submitted by the licensee on the latest valuations (ie at 31 March 2016); and b) determines the Established Deficit, revalued based on actuarial information as at 31 March 2016.	"A"
5		Established Deficit amount as at 31 March 2016 is deflated to 2012/13 prices using actual RPI data in accordance with paragraph 1.6.	"B"
6		Remaining deficit repair period established as 7 years (2024/25 minus 2017/18).	
7		Annual Pension Scheme Established Deficit repair allowance in 2012/13 prices computed as: = "B" / ((1-(1+DR)^ -7) / LN(1+DR)) Where: DR is the discount rate determined by a benchmarking process against energy network operators pre-retirement discount rates as applied in their valuations at step 1 and moderated against similar rates reported for occupational pension schemes in Great Britain; and LN returns the natural logarithm of the subject value. If there is a surplus shown by the valuation, B and C1 are set to zero and paragraph 3.21 below applies.	"C1"
Adjustments relating to licensee payment history in 2013/14, 2014/15 and the RIIO-ED1 period			
8	By 31 October 2017	Ofgem determines the actual deficit repair payment attributable to the licensee by: (a) obtaining the relevant portion (attributable to the licensee's distribution business) of the actual deficit repair payments made by the licensee in 2013/14, 2014/15, 2015/16 and 2016/17, excluding any amounts relating to contingent asset costs.	"$D_{2013/14}$" "$D_{2014/15}$" "$D_{2015/16}$" "$D_{2016/17}$"

(b) adjusting for any disallowed costs for each Regulatory Year arising from Ofgem's reasonableness review (DC).

(c) Deflating the resulting values to 2012/13 prices using actual RPI data in accordance with paragraph 1.6.

The result of steps (a) to (c) above are represented as:

$(ED – DC) * (RPI_{2012/13} / RPI_{year})$

The formula for $D_{2013/14}$ is as follows:

$(ED_{2013/14} – DC_{2013/14}) * (RPI_{2012/13} / RPI_{2013/14})$

The formula for $D_{2014/15}$ is as follows:

$(ED_{2014/15} – DC_{2014/15}) * (RPI_{2012/13} / RPI_{2014/15})$

The formula for $D_{2015-16}$ is as follows:

$(ED_{2015/16} – DC_{2015/16}) * (RPI_{2012/13} / RPI_{2015/16})$

The formula for $D_{2016-17}$ is as follows:

$(ED_{2016/17} – DC_{2016/17}) * (RPI_{2012/13} / RPI_{2016/17})$

Where:

"ED_{year}"	means the licensee portion of Established Deficit repair payment total during the relevant Regulatory Year, in nominal prices excluding payments made in respect of contingent assets[14].
"DC_{year}"	means the value of disallowed costs for the relevant Regulatory Year arising from Ofgem's relevant reasonableness review.
"$RPI_{2012/13}$"	means the arithmetic average of the Retail Prices Index (all items) figures published by the Office for National Statistics for each calendar month in Regulatory Year 2012/13 rounded to three decimal places.
"RPI_{year}"	means the arithmetic average of the Retail Prices Index (all items) figures published

[14] See Glossary

		by the Office for National Statistics for each calendar month in the relevant Regulatory Year rounded to three decimal places.	
9		Ofgem obtains the pre-existing EDE allowance for 2015/16 and 2016/17 (excluding any true-up amounts and where applicable any allowance for contingent asset costs), as set out in the RIIO-ED1 Final Determination for comparison with the licensee's actual deficit repair payment. Ofgem obtains the revised amounts for 2014/15 (including any true-up amounts) in 2012/13 prices, used for the provisional true up of the DPCR5 allowances, which were applied in setting the RIIO-ED1 Final Determination for comparison with the licensee's actual deficit repair payment.	"$E_{2014/15}$" "$E_{2015/16}$" "$E_{2016/17}$"
10		Ofgem obtains the difference between the pre-existing allowance and actual payments, and adjusts for tax and the Time Value of Money. This is computed as: "D" – "E" using the following steps. (a) To ensure the correct treatment of costs after considering the impact of corporation tax, where the licensee has "modelled" taxable profits in the year, there is a need to deduct the value of corporation tax (attributable to relevant deficit repair payments and allowances) to give the post-tax value of deficit repair payments and allowances for the year in question. This is calculated at the actual rate of corporation tax applicable to the relevant Regulatory Year (CT_{year}). If the licensee does not have "modelled" taxable profits for the year, this step is omitted. (b) Adjust for the Time Value of Money through to the date where EDE allowance values will be revised, ie 1 April 2018. (c) To obtain the correct value to include in the PCFM this value is then divided by ($1-CT_{2018/19}$) to give the correct tax adjusted value. Steps (a) to (c) are computed for each Regulatory Year as set out below: The formula for $F_{2013/14}$ is as follows:	"F"

		$[(D_{2013/14} - E_{2013/14}) * (1 - CT_{2013/14}) * (1 + WACC_{2013/14}) * (1 + WACC_{2014/15}) * (1 + WACC_{2015/16}) * (1 + WACC_{2016/17}) * (1 + WACC_{2017/18})] / (1 - CT_{2018/19})$ The formula for $F_{2014/15}$ is as follows: $[(D_{2014/15} - E_{2014/15}) * (1 - CT_{2014/15}) * (1 + WACC_{2014/15}) * (1 + WACC_{2015/16}) * (1 + WACC_{2016/17}) * (1 + WACC_{2017/18})] / (1 - CT_{2018/19})$ The formula for $F_{2015-16}$ is as follows: $[(D_{2015/16} - E_{2015/16}) * (1 - CT_{2015/16}) * (1 + WACC_{2015/16}) * (1 + WACC_{2016/17}) * (1 + WACC_{2017/18})] / (1 - CT_{2018/19})$ The formula for $F_{2016-17}$ is as follows: $[(D_{2016/17} - E_{2016/17}) * (1 - CT_{2016/17}) * (1 + WACC_{2016/17}) * (1 + WACC_{2017/18})] / (1 - CT_{2018/19})$ The value of "F" is: "F" = $F_{2013/14} + F_{2014/15} + F_{2015/16} + F_{2016/17}$ Where: "CT_{year}" means the actual rate of Corporation Tax applicable in the Regulatory Year, or is zero if the licensee does not have modelled" taxable profits for the year. "$CT_{2018/19}$" means the actual rate of Corporation Tax applicable in the Regulatory Year that EDE values are revised, ie Regulatory Year 2018/19, or is zero if the licensee does not have "modelled" taxable profits for the year. "$WACC_{year}$" means the Vanilla Weighted Average Cost of Capital attributable in the relevant Regulatory Year.	
11		Ofgem spreads the difference between the pre-existing allowance and actual payment evenly over the remaining 7 years of the notional 15-year funding period: The adjusting amount relating to each Regulatory Year is computed (in 2012/13 prices) as:	"G1"

		"G1" = value "F" / ((1-(1+DR)^ -7) / LN(1+DR)) Where: DR is the discount rate determined using the methodology described in row 7. The value "G1" may be either positive (if the actual payment is greater than the pre-existing allowance), or negative (if the actual payment is less than the pre-existing allowance).	
12		Ofgem calculates revised EDE values for the remaining years of RIIO-ED1, ie for each Regulatory Year from 2018/19 to 2022/23. This is calculated as: "C1" + "G1". Note 2018/19 will remain the first Regulatory Year for which the EDE value is revised in the event that the adjustment is delayed by one or more years.	

3.20 The adjustment contained in Row 11 of Table 3.2 deals with a situation where the licensee has paid across more, or less, than the allowance (EDE value excluding true ups and also excluding, where relevant, any contingent asset allowances) it was given for a particular Regulatory Year.

Scheme surplus

3.21 If the difference between the assets and corresponding liabilities referred to in paragraph 3.6 represents a surplus position for the Established Deficit as at 31 March 2016, then EDE values for "C1" at step 7 in table 3.2 above for Regulatory Years from 2018/19 onwards will be revised to zero pending the next review process set out in Table 3.3. The policy position with regard to pension scheme surpluses is set out in the March 2013 Strategy document (see associated document a.).

Determination and direction of revised EDE values by 30 November 2020

3.22 Subject to paragraph 3.24, revised EDE values will be determined by 30 November 2020 for each Regulatory Year from 2020/21 to 2022/23 using the methodology set out in Table 3.3 below.

Table 3.3 - Process for determining revised EDE values to be directed by 30 November 2020

Row	Timing	Event	Value
1	By 7 July 2020	Ofgem obtains the actuarial scheme valuation (on the basis set out in paragraph 3.17) for the licensee's defined benefit	

		pension scheme as at 31 March 2019, together with scheme datasets, and commences a reasonableness review of all network operators' valuations as at 31 March 2019.	
2	By 31 July 2020	Ofgem receives price control review information from the licensee covering Regulatory Years 2017/18, 2018/19 and 2019/20.	
3	By 30 September 2020	Licensee submits deficit allocation information and indicative Pension Scheme Established Deficit figure relating to service up to 31 March 2010 as at 31 March 2019 and the movements from 1 April 2016 to 31 March 2019 in accordance with the deficit allocation methodology.	
4	By 31 October 2020	a) Ofgem carries out a reasonableness review of information submitted by the licensee on the latest valuation; and b) determines the Established Deficit amount, revalued based on actuarial information as at 31 March 2019.	"A"
5		Established Deficit amount as at 31 March 2019 is deflated to 2012/13 prices using actual RPI data in accordance with paragraph 1.6.	"B"
6		Remaining deficit repair period established as 4 years (2024/25 minus 2020/21).	
7		Annual Pension Scheme Established Deficit repair allowance in 2012/13 prices computed as: = "B" / ((1-(1+DR)^ -4) / LN(1+DR)) Where: DR is the discount rate determined by a benchmarking process against energy network operators' pre-retirement discount rates as applied in their valuations at step 1 and moderated against similar rates reported for occupational pension schemes in Great Britain; and LN returns the natural logarithm of the subject value. If there is a surplus shown by the valuation, B and C2 are set to zero and paragraph 3.24 below applies.	"C2"
Adjustment relating to licensee payment history in RIIO-ED1 period			
8	By 31	Ofgem determines the actual deficit repair payment attributable to the licensee by: (a) Obtaining the relevant portion (attributable to the licensee's distribution business) of the actual deficit repair payments made by the licensee in 2017/18,	"$D_{2017/18}$" "$D_{2018/19}$" "$D_{2019/20}$"

	October 2020	2018/19 and 2019/20. (b) Adjusting for any disallowed costs for each Regulatory Year arising from Ofgem's reasonableness review (DC). (c) Deflating the resulting values to 2012/13 prices using actual RPI data in accordance with paragraph 1.6 The result of steps (a) to (c) above are represented as: $(ED - DC) * (RPI_{2012/13} / RPI_{year})$ The formula for $D_{2017/18}$ is as follows: $(ED_{2017/18} - DC_{2017/18}) * (RPI_{2012/13} / RPI_{2017/18})$ The formula for $D_{2018/19}$ is as follows: $(ED_{2018/19} - DC_{2018/19}) * (RPI_{2012/13} / RPI_{2018/19})$ The formula for $D_{2019/20}$ is as follows: $(ED_{2019/20} - DC_{2019/20}) * (RPI_{2012/13} / RPI_{2019/20})$ Where: "ED_{year}" means the Established Deficit repair payment total during the relevant Regulatory Year, in nominal prices excluding payments made in respect of contingent assets[15]. "DC_{year}" means the value of disallowed costs for the relevant Regulatory Year arising from Ofgem's reasonableness review. "$RPI_{2012/13}$" means the arithmetic average of the Retail Prices Index (all items) figures published by the Office for National Statistics for each calendar month in Regulatory Year 2012/13 rounded to three decimal places. "RPI_{year}" means the arithmetic average of the Retail Prices Index (all items) figures published by the Office for National Statistics for each calendar month in the relevant Regulatory Year rounded to three decimal places.	
9		Ofgem obtains the pre-existing EDE allowance for 2017/18,	"$E_{2017/18}$"

[15] See Glossary

		2018/19 and 2019/20 (excluding any true-up amounts and where applicable any allowance for contingent asset costs) in 2012/13 prices (as previously revised under this chapter) for comparison to licensee's actual deficit repair payments.	"$E_{2018/19}$" "$E_{2019/20}$"
10		Ofgem obtains the difference between the pre-existing allowance and actual payments, and adjusts for tax and the time value money. This is computed as: "D" – "E" using the following steps. (a) To ensure the correct treatment of costs after considering the impact of corporation tax, where the licensee has "modelled" taxable profits in the year, there is a need to deduct the value of corporation tax (attributable to relevant deficit repair payments and allowances) to give the post-tax value of deficit repair payments and allowances for the year in question. This is calculated at the actual rate of corporation tax applicable to the relevant Regulatory Year (CT_{year}). If the licensee does not have "modelled" taxable profits for the year, this step is omitted. (b) Adjust for the Time Value of Money through to the date where EDE allowance values will be revised, ie 1 April 2021. (c) To obtain the correct value to include in the PCFM this value is then divided by ($1-CT_{2021/22}$) to give the correct tax adjusted value. Steps (a) to (c) are computed for each Regulatory Year as set out below: The formula for $F_{2017/18}$ is as follows: $[(D_{2017/18} - E_{2017/18}) * (1 - CT_{2017/18}) * (1 + WACC_{2017/18}) * (1 + WACC_{2018/19}) * (1 + WACC_{2019/20}) * (1 + WACC_{2020/21})] / (1 - CT_{2021/22})$ The formula for $F_{2018/19}$ is as follows: $[(D_{2018/19} - E_{2018/19}) * (1 - CT_{2018/19}) * (1 + WACC_{2018/19}) * (1 + WACC_{2019/20}) * (1 + WACC_{2020/21})] / (1 - CT_{2021/22})$ The formula for $F_{2019/20}$ is as follows: $[(D_{2019/20} - E_{2019/20}) * (1 - CT_{2019/20}) * (1 + WACC_{2019/20}) * (1$	"F"

		$+ WACC_{2020/21})] / (1 - CT_{2021/22})$ The value of "F" is: "F" = $F_{2017/18} + F_{2018/19} + F_{2019/20}$ Where: "CT_{year}" means the actual rate of Corporation Tax applicable in the Regulatory Year, or is zero if the licensee does not have "modelled" taxable profits for the year. "$CT_{2021/22}$" is the actual rate of Corporation Tax applicable in the Regulatory Year that EDE values are revised, ie Regulatory Year 2021/22, or is zero if the licensee does not have "modelled" taxable profits for the year. "$WACC_{year}$" means the Vanilla Weighted Average Cost of Capital attributable in the relevant Regulatory Year.	
11		Ofgem spreads the difference between the pre-existing allowance and actual payment evenly over the remaining 4 years of the notional 15-year funding period: The adjusting amount relating to each Regulatory Year is computed (in 2012/13 prices) as: "G2" = value "F" / ((1-(1+DR)^ -4) / LN(1+DR)) Where: DR is the discount rate determined using the methodology described in row 7. The value "G2" may be either positive (if the actual payment is greater than the pre-existing allowance), or negative (if the actual payment is less than the pre-existing allowance).	"G2"
12		Ofgem obtains revised EDE values for the remaining years of RIIO-ED1, ie for each Regulatory Year from 2020/21 to 2022/23. This is calculated as: "C2" + "G2" + "G1" (from Table 3.2 above).	

3.23 The adjustment contained in Row 11 of Table 3.3 deals with a situation where the licensee has paid across more, or less, than the allowance (EDE value as previously revised) it was given for a particular Regulatory Year.

Scheme surplus

3.24 If the difference between the assets and corresponding liabilities referred to in paragraph 3.6 represents a surplus position for the Established Deficit as at 31 March 2019, values for item "C2" at step 7 in table 3.3 above for Regulatory Years from 2021/22 onwards will be revised to zero pending the next triennial scheme valuation and review. The policy position with regard to pension scheme surpluses is set out in Ofgem's pension principles in the March 2013 Strategy document (see associated document a.).

Direction of revised EDE values

3.25 The Authority will direct revised EDE values by no later than 30 November 2017 and 30 November 2020 in accordance with the procedure set out in Part D of Charge Restriction Condition 3C.

Part 4 - Processing of revised EDE values under the Annual Iteration Process

3.26 EDE values, as revised, are included in full in recalculated base revenue figures in the PCFM under the Annual Iteration Process and are treated as 100 per cent fast money. Revisions to EDE values will, however, also have ancillary effects on other calculations under the Annual Iteration Process, which also feed into recalculated base revenue figures.

3.27 Incremental changes to recalculated base revenue figures for years earlier than Regulatory Year t will, subject to a Time Value of Money adjustment, be brought forward and reflected in the calculation of the term MOD to be directed for Regulatory Year t. For the avoidance of doubt, such a revision will not have any retrospective effect on a previously directed value of the term MOD.

3.28 EDE values are not added to RAV and are not subject to the Totex Incentive Mechanism.

4. Tax liability allowances - financial adjustment methodologies

Part 1 - Overview

4.1 The Opening Base Revenue Allowances ('PU' values) for the licensee set down in the table at Appendix 1 to Charge Restriction Condition 2A (Restriction of Allowed Distribution Network Revenue) include tax liability allowances that are modelled at the outset of the Price Control Period to take account of:

(a) existing and announced corporation tax rates and writing down allowance rates;

(b) existing legislation, case law, accounting standards and HM Revenue & Customs (HMRC) policy; and

(c) modelled levels of gearing and corporate debt interest payments for the licensee.

4.2 Part B of Charge Restriction Condition 3C provides for adjustments to be made to the licensee's tax liability allowances[16] during the Price Control Period through the Annual Iteration Process for the ED1 Price Control Financial Model (PCFM). Changes to the factors referred to at sub-paragraphs 4.1(a) and (b) are referred to as 'tax trigger events' and the methodology for adjustments is set out in Part 2 of this chapter. Changes to the factors referred to at sub-paragraph 4.1(c) are referred to as 'tax clawbacks' and the methodology for adjustments is set out in Part 3 of this chapter.

Annual Iteration Process

TTE and TGIE values

4.3 The adjusting of the licensee's tax liability allowances and regulatory tax losses balance (see paragraph 4.10) is carried out through the Annual Iteration Process for the PCFM. The PCFM Variable Values Table for the licensee contains rows for PCFM Variable Values for tax liability allowance adjustments relating to:

- tax trigger events ('TTE' values); and
- tax clawbacks ('TGIE values').

[16] References in this chapter to tax liabilities are references to liabilities for corporation tax only and not to any other type of taxation.

4.4 TTE and TGIE values represent £m amounts. As at 1 April 2015, the TTE and TGIE values for the licensee, for each Regulatory Year will be zero. Part B of Charge Restriction Condition 3C (Specified financial adjustments) provides for any revisions to TTE and TGIE values to be directed after determination under the methodologies in this chapter.

4.5 Subject to paragraph 4.6, revisions to TTE and TGIE values feed into the recalculated base revenue figures and/or the regulatory tax loss balances for applicable Regulatory Years in the PCFM through the Annual Iteration Process. Incremental changes to recalculated base revenue figures for years earlier than Regulatory Year t are, subject to a Time Value of Money Adjustment, brought forward and reflected in the calculation of the term MOD to be directed for Regulatory Year t. For the avoidance of doubt, such changes will not have any retrospective effect on a previously directed value of the term MOD.

4.6 Any recalculation of the licensee's tax liability allowances necessarily includes an iterative modelling aspect: an increased allowance gives rise to an increased liability which requires an increased allowance and so on. The effect can be either positive or negative. This 'tax allowance on tax allowance' issue is dealt with as follows:

- In respect of tax trigger adjustments, revised TTE values (determined using the tax trigger calculation tool referred to in the methodology in Part 2 of this chapter) incorporate the iterative calculations and no further processing is required as part of the Annual Iteration Process.
- In respect of tax clawback adjustments, revised TGIE values (determined under the methodology in Part 3 of this chapter) do not incorporate the iterative calculations and these are instead factored into recalculated base revenue figures by functionality within the PCFM as part of the Annual Iteration Process.

It should be noted that underlying tax liability allowances for the licensee within the PCFM might also be changed under the Annual Iteration Process as a consequence of other variable value changes, such as increases in allowed Totex expenditure. However, these changes are distinct from the specific adjustments to tax liability allowances under the methodologies in this chapter.

Legacy price control adjustments to opening tax pool balances

4.7 Tax liability allowance calculations under the Annual Iteration Process make use of regulatory tax pool balance figures held within the PCFM. The opening balances (as at 1 April 2015) for these tax pools may be subject to legacy price control adjustments through revisions to LTPG, LTPS, LTPD and LTPS PCFM Variable Values. These adjustments are covered in chapter 14. The allocation of component elements of allowed Totex expenditure to capital allowance pools and revenue expenditure in the PCFM will not be updated in the Price Control Period.

Price bases for tax calculations

4.8 The PCFM works predominantly in constant 2012/13 prices, with all inputs and outputs in this price base. Where applicable, financial amounts that are expressed in later, nominal prices, will be deflated to 2012/13 prices in accordance with paragraph 1.6 in chapter 1 before being used to determine revised TTE and TGIE values.

4.9 The PCFM uses nominal prices for some internal tax calculation functions. For this purpose, the PCFM refers to RPI forecast values set at the outset of the Price Control Period.

Regulatory tax losses

4.10 In some instances, the approach to calculating tax liability allowances could imply that the licensee could receive a negative allowance. In such cases, the price control treatment is to model a zero allowance; and to record the tax loss arising as a 'regulatory tax loss' figure, to be deducted from the taxable profits before the tax is calculated for any tax liability allowances which would otherwise be allocated to the year concerned or later years. The regulatory tax loss balance attributable to each Regulatory Year (together with a running total) is held within the PCFM and regulatory tax losses are referred to where applicable in the methodologies in this chapter.

Group tax arrangements

4.11 For the purposes of the methodology set out in Part 2 of this chapter, tax liabilities, allowances and trigger events are considered on a notional 'licensee business' basis, and consequently the following are disregarded in the assessment of tax liabilities and allowances for price control purposes:

- the claim or surrender of group tax relief (including consortium relief);
- interest payments (including any coupons on debt instruments or preference share dividends) and receipts that are not tax deductible or chargeable under HMRC rules for the purposes of computing the licensee's taxable profits, including but not limited to adjustments for transfer pricing and the 'worldwide debt cap'; and
- any other adjustments required in appendix 1 of Ofgem's open letter dated 31 July 2009 (Clawback of tax benefit due to excess gearing)[17].

[17] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=49&refer=Networks and as amended for the treatment of hybrid financial instruments

4.12 For the purposes of the methodology set out in Part 3 of this chapter, levels of debt, interest and gearing are considered at licensee level, as opposed to any other level with respect to the corporate or ownership group of which the licensee is a member.

Part 2 - Adjustments driven by tax trigger events - methodology

4.13 The methodology set out in this Part provides for the licensee's tax liability allowances to be adjusted (subject to a threshold described below) to take account of tax trigger events. This means that consumers will derive a benefit when tax liability costs fall materially, and the licensee will be appropriately reimbursed when they rise.

Tax trigger events

4.14 There are two types of tax trigger event for the purposes of tax liability allowance adjustments:

Type A

Type A events consist of:

- changes to corporation tax rates, applicable to one or more Regulatory Years; and
- changes to capital allowance rates applicable to one or more Regulatory Years.

Type B

Type B events consist of other factors (exogenous to the licensee, its owners or controllers) that cause a change to the licensee's notional tax liabilities[18] for one or more Regulatory Years including:

- changes to applicable legislation;
- the setting of legal precedents through case law;
- changes to HMRC interpretation of legislation; and
- changes in accounting standards.

4.15 Where a Type B event consists of changes to statutory capital allowance pools, or to the allocation of expenditure to such pools, an appropriate £m

[18] The tax liability which would be modelled if the event was taken into account.

adjustment (from the effective date of the new requirement) will be factored into subsequent TTE value revisions for the licensee. We will work with licensees to agree the financial effect of revised tax pool allocation requirements where these are not straightforward.

4.16 Type B events will only be taken into account for the purposes of increasing the licensee's tax liability allowances where the licensee has demonstrably used its reasonable endeavours to minimise any increase in its tax liabilities.

Materiality threshold and 'deadband'

4.17 A materiality threshold (is applied to tax trigger events during the Price Control Period and a £m threshold amount for each Regulatory Year is included amongst the fixed values on the Tax Trigger sheet for the licensee in the PCFM.

4.18 A change to the licensee's notional tax liability allowance for a particular Regulatory Year is only applied where one or more trigger events would result in a tax liability change for that year whose absolute value is greater than the threshold amount. Furthermore, any change to the tax liability allowance (upward or downward) is limited to the amount that is in excess of the threshold amount for the Regulatory Year concerned.

4.19 Where the change to the licensee's tax liability allowance for a particular Regulatory Year is below the threshold, subsequent tax trigger events, relating back to that Regulatory Year could cause the threshold amount to be exceeded. In that case, a change to the licensee's tax liability allowance for the Regulatory year concerned (a revised TTE value) would be determined once the threshold had been exceeded. It should be noted that there is no retrospective adjustment to the value of MOD terms already directed; adjustments would instead be included in the calculation of a subsequent value for the term MOD.

4.20 For the avoidance of doubt, a regulatory tax loss figure attributable to a particular Regulatory Year is not taken into account for the purposes of deciding whether the threshold amount has been exceeded for that year.

Accounting standards

4.21 The licensee's tax liability calculations are subject to:

- changes to applicable legislation;
- the setting of legal precedents through case law;
- changes to HMRC interpretation of legislation; and

- changes in accounting standards applicable to preparation of the licensee's statutory accounts[19].

4.22 The accounting frameworks to be applied by the licensee for the purpose of computing tax liabilities are either:

- EU-IFRS, if adopted for use by the licensee; or
- UK GAAP under Financial Reporting Standard 102.

Notification of tax trigger events

Type A trigger events

4.23 Ofgem will, by 30 September in each Regulatory Year t-1, notify the licensee of the Type A trigger events that it proposes to take into account in determining any revised TTE values for use in the Annual Iteration Process that is required to take place by 30 November in that same Regulatory Year t-1. It is, however, open to the licensee to contact Ofgem in advance of 30 September in each Regulatory Year t-1 to discuss the current view of Type A events. The notification from Ofgem will specify the corporation tax rate change(s) or changes to rates of capital allowances concerned and the Regulatory Years to which they relate.

4.24 If, after receiving the notification referred to in paragraph 4.23, the licensee considers that a Type A trigger event has occurred, that has not been included in the notification, it should contact Ofgem within 14 days and provide details of the event concerned. If Ofgem agrees that a further Type A trigger event has occurred, it will notify the licensee by 31 October in the same Regulatory Year t-1.

4.25 If any Type A trigger event is left out of account when it ought to have been included in the determination of a revised TTE value (either because it was not included in a notice or otherwise) the position will be rectified in a subsequent revision of the TTE value(s) concerned. In such a case, the functionality of the PCFM means that a Time Value of Money Adjustment would be applied.

Type B trigger events

4.26 The licensee must notify Ofgem by not later than 31July in each Regulatory Year t-1 of all the Type B trigger events that it has become aware of by that time, except those which have been previously notified. This requirement applies equally to events which could be expected to increase or to reduce the licensee's tax liability allowances.

[19] Section 385 of the Companies Act 2006 refers.

4.27 For the purpose of complying with the requirement set out in paragraph 4.26, the licensee must use its reasonable endeavours to identify and record Type B trigger events.

4.28 The notification referred to in paragraph 4.26 should include, in respect of each Type B trigger event:

(a) a description of the event;

(b) the changes in tax liability allowances that the event is considered to have caused and the Regulatory Years to which they relate;

(c) the calculations (including all relevant parameters and values) that the licensee used to arrive at the amounts referred to in subparagraph (b) – in performing these calculations the licensee should include a 'tax allowance on tax allowance' factor as explained in paragraph 4.6 but should ignore the tax trigger deadband which is adjusted for in paragraph 4.37;

(d) any relevant information provided by HMRC in relation to the event;

(e) evidence of mitigating measures that the licensee has taken to minimise any additional liabilities arising from the event; and

(f) comments by the licensee on:

- the relevance of the event to its tax position,
- whether grounds exist to contest the applicability of the event to the licensee, and
- the reporting treatment the licensee expects to apply in its tax submissions to HMRC and in its statutory accounts.

4.29 The licensee's notification should also state whether it considers that the materiality threshold (see paragraph 4.17) has been exceeded for the Regulatory Year(s) concerned, taking into account the total net amount of tax liability changes (upward and downward) included in the current notification and any previous notifications.

4.30 Ofgem will review any notifications given to it by the licensee under paragraph 4.26 and may ask the licensee:

- for additional information in respect of one or more of the notified events; and/or
- to submit the results of agreed upon audit procedures specified by Ofgem and carried out by the licensee's appropriate auditors[20], to assist in confirming the appropriateness and accuracy of the licensee's calculations.

[20] As defined in the Standard Conditions of the Electricity Distribution Licence

4.31 Ofgem will inform the licensee by 30 September in the same Regulatory Year t-1 whether, in respect of each Type B trigger event:

(a) it has agreed (on a provisional or confirmed basis) the change in tax liabilities figure calculated by the licensee;

(b) it has determined (on a provisional or confirmed basis) a different change in tax liabilities figure from that calculated by the licensee; or

(c) it has decided that consideration of any change in tax liabilities should be deferred until further/better information is available.

4.32 In deciding which of the actions set out in paragraph 4.31 should be taken, Ofgem will, without limitation, take account of whether the licensee has conclusively agreed its tax liabilities for the Regulatory Year concerned with HMRC. Where there has been a provisional agreement/determination or a deferral of consideration, the TTE values concerned will be subject to further revision for the purposes of a later Annual Iteration Process (see also paragraph 4.41).

4.33 Where Ofgem determines a different change in tax liabilities figure from that calculated by the licensee or decides that consideration of any change in tax liabilities should be deferred, it will set out its reasons and/or calculations. The licensee has the right to reply setting out its objections, which Ofgem will consider.

4.34 Ofgem will also notify the licensee by 30 September in each Regulatory Year t-1 of any Type B trigger events that it proposes to take into account that have not been included in a notification sent to Ofgem by the licensee. The licensee has the right to reply setting out its objections, which Ofgem will consider.

Logging of trigger events

4.35 Ofgem will keep a log of tax trigger events that have been subject to notifications by it or by the licensee showing for each event:

- a description of the event and whether it was Type A or Type B;
- the name of the party who notified the event (Ofgem or licensee);
- the date of notification;
- the amount of any change in the licensee's tax liabilities that has been determined under the procedures set out below; and
- details of any events for which a determination is in abeyance and a description of the outstanding actions to be taken.

Determination and direction of revised TTE values

Determination of revised TTE values using the tax trigger calculation tool

4.36 The design of the PCFM includes additional functionality meaning that a copy of the PCFM can be used as a tax trigger calculation tool, as an adjunct to the Annual Iteration Process.

4.37 Once a tax trigger event has taken place at any point in the RIIO-ED1 Price Control Period, then after 31 October in each Regulatory Year t-1, Ofgem will generate a duplicate copy of the PCFM, in its state following the last completed Annual Iteration Process (but including any subsequent functional modifications made under the provisions of Charge Restriction Condition 4A) for use as the tax trigger calculation tool. It will then take the following steps to determine TTE values for each licensee:

(i) All of the other PCFM Variable Value revisions that have been determined for use in the prospective Annual Iteration Process (and which Ofgem expects to include in the notices of proposed Variable Value revisions to licensees) will be input into the PCFM Variable Values Table for the licensee. The correct Regulatory Year will be selected using the PCFM 'year t selector' on the User Interface worksheet of the PCFM.

(ii) All of the existing TTE values will be reset to zero.

(iii) Any existing values in the yellow input cells on the tax trigger worksheet will be cleared with the exception of the tax deadband values.

(iv) The 'Tax allowance before tax trigger' amount for the licensee for each Regulatory Year shown on the tax trigger worksheet will be noted.

(v) The PCFM copy will be put into 'tax trigger tool mode' using the selector on the User Interface worksheet.

(vi) Changes to corporation tax rates or writing down allowance rates (reflecting Type A trigger events) will be input into the yellow input cells in the appropriate rows and Regulatory Year columns on the tax trigger worksheet.

(vii) The tax trigger macro calculation programmed into the workbook will be run.

(viii) The aggregate changes to the licensee's tax liability allowances determined in respect of all Type B trigger events (whether notified during Regulatory Year t-1 or on an earlier occasion) will be input into the yellow input cells on the 'Type B event values' row in the appropriate Regulatory Year columns on the tax trigger worksheet. This value should include the iterative tax allowance on tax allowance factor referred to in paragraph 4.6.

(ix) The tax trigger macro calculation will be rerun.

(x) The 'Tax allowance (before utilisation of brought forward losses) before tax trigger' referred to at step (iv) will be deducted from the 'Tax allowance' that has been calculated based on the new inputs (including both Type A and Type B trigger events).

(xi) The absolute value of the amount obtained under step (x) will be ascertained.

(xii) If the absolute value ascertained at step (xi) is less than the deadband amount (which is a fixed amount for each Regulatory Year), the tax trigger adjustment is shown as zero; otherwise step (xiii) applies.

(xiii) If the value calculated at step (xi) is greater than the deadband amount then:

  (i) if the amount obtained under step (x) is negative, the tax trigger adjustment is shown as that amount plus the deadband; or

  (ii) if the amount obtained under step (x) is positive, the tax trigger adjustment is shown as that amount minus the deadband.

4.38 Subject to paragraph 4.41, the relevant amounts obtained under step (xii) or (xiii) will then be determined to be the TTE values for the licensee for each Regulatory Year where the deadband has been exceeded. Where these values differ from the TTE values shown on the PCFM Variable Values Table for the licensee (following the last completed Annual Iteration Process), Ofgem will direct that the TTE values concerned are to be revised in accordance with the process set out in Part E of Charge Restriction Condition 3C and referred to below.

4.39 The process set out in paragraph 4.37 will be re-performed if any of the prospective PCFM Variable Value revisions, referred to at step (i) are changed, to ensure that accurate TTE values are available for the Annual Iteration Process.

Notes on the tax trigger calculation (see paragraph 4.37)

- The two stage calculation process referred to in steps (vii) and (ix) allows the tax trigger calculation tool to take full account of the interrelationship between Type A and Type B events.
- The nullification of existing TTE values referred to in step (ii) together with the inclusion of all determined changes to the licensee's tax liabilities referred to in step (viii) ensures that the determination of TTE values under step (xiii) is on a consistent basis and accurately applies the materiality threshold/ deadband applicable to each Regulatory Year.
- The inclusion of all available revisions to other PCFM Variable Values under step (i) ensures that the tax allowance calculation is as up to date as possible for each Regulatory Year.
- Once a tax trigger event has occurred in any year, the tax trigger calculation will need to be run in respect of all subsequent Annual Iteration Processes, even if no further tax trigger event has occurred.

Direction of revised TTE values

4.40 The Authority will direct any revisions to TTE values for the licensee by 30 November in each Regulatory Year t-1, having given the licensee at least 14 days' notice of the values which it proposes to direct.

4.41 Revised TTE values can be directed in respect of a particular Annual Iteration Process for any Regulatory Year during the Price Control Period, including for years later than Regulatory Year t.

4.42 The procedure for the Authority's direction of revised TTE values is set out in Part D of Charge Restriction Condition 3C.

Part 3 - Adjustments driven by gearing levels and corporate debt interest costs ('tax clawback') - methodology

4.43 At the outset of the Price Control Period, modelling assumptions are made about financing requirements, gearing levels and corporate debt costs for the licensee's business. These assumptions result in modelled levels of tax deductible interest costs and associated tax relief for the licensee.

4.44 If the licensee operates at a higher level of gearing than the modelled level, it stands to benefit from the tax value of higher levels of deductibility. Ofgem applies a mechanism that claws back this benefit for consumers by updating the licensee's tax liability allowances using the methodology set out in this Part. It should be noted that there is no provision to give additional tax allowances to the licensee if it chooses to operate at a level of gearing lower than the modelled one.

Determination and direction of revised TGIE values

4.45 As a function of each Annual Iteration Process for the PCFM, the expected (modelled) amount of tax deductible interest payable by the licensee is recalculated for each Regulatory Year in the Price Control Period. Recalculated interest figures are shown on the Finance and Tax worksheet of the PCFM and it is the 'core' amount of interest associated with base revenue calculations that is relevant for tax clawback considerations and which is referred to in the remainder of this Part.

4.46 After 30 September in each Regulatory Year, Ofgem will obtain the following values from a copy of the PCFM, in its state following the last completed Annual Iteration Process (and including any functional modifications under Charge Restriction Condition 4A)[21]:

[21] The determination in respect of Regulatory Year t-2 will use the data subsisting immediately after the preceding Annual Iteration Process, which will have taken place by 30 November in Regulatory Year t-2. It will not therefore have been updated in respect of information

(i) the most recently modelled figure for tax deductible interest payable by the licensee in Regulatory Year t-2; and

(ii) the licensee's indicative RAV balance in 2012/13 prices as at 31 March in Regulatory Year t-2.

4.47 The indicative RAV balance referred to in paragraph 4.46(ii) will then be inflated to year-end prices for Regulatory Year t-2, using the arithmetic average of the RPI data for March and April of Regulatory Year t-2.

4.48 The licensee is required to submit its price control cost information return by 31 July in each Regulatory Year t-1, in accordance with Standard Condition 46 (Regulatory instructions and guidance) of the Electricity Distribution Licence and the RIGs issued under that condition.

4.49 Ofgem will obtain from the 'tax clawback data table' in that submission the licensee's:

(i) reported figure for adjusted net debt as at 31 March in Regulatory Year t-2; and

(ii) reported figure for tax deductible net interest paid during Regulatory Year t-2, measured on an accruals basis.

4.50 The tax deductible net interest paid figure referred to in paragraph 4.49(ii) is ascertained on an accruals basis and is subject to adjustment by Ofgem in accordance with the RIGs.

4.51 The criteria that the licensee must observe in reporting the figures referred to in paragraph 4.49 are set out in the RIGs and are subject to review by Ofgem in this regard.

Applicability tests

4.52 Ofgem will use two tests: a gearing level test and a positive tax benefit test, to determine the TGIE value for the licensee in respect of Regulatory Year t-2.

Gearing level test

4.53 Ofgem will divide the licensee's net debt figure as at 31 March in Regulatory Year t-2 (see paragraph 4.49(i)) by the licensee's indicative PCFM RAV balance (see

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reported by the licensee during Regulatory Year t-1. However, the annual re-performance of the determination for preceding years will ensure that finalised figures are subsequently taken into account.

paragraph 4.49(ii) as at 31 March in Regulatory Year t-2 to calculate the licensee's gearing ratio.

4.54 If the calculated gearing ratio established under paragraph 4.53, expressed as a percentage, is greater than the notional level of gearing of 65 percent (shown as a fixed input value on the Inputs sheet of the PCFM) then the positive benefit test set out below will be performed. If the calculated gearing ratio is lower than the notional level of gearing, then the positive benefit test is not performed and the value of TGIE for Regulatory Year t-2 will be determined to be zero.

Positive benefit test

4.55 Ofgem will subtract the modelled figure for tax deductible interest payable by the licensee in Regulatory Year t-2 (see paragraph 4.49(i)) from the licensee's reported figure for tax deductible net interest paid during Regulatory Year t-2 (see paragraphs 4.49(ii) and 4.50). For the purpose of this calculation, amounts of interest payable are treated as positive numbers.

4.56 If the result of the calculation set out in paragraph 4.55 is a positive value, demonstrating a positive benefit, then a tax clawback adjustment is applicable. In this case Ofgem will multiply the positive value by the corporation tax rate for Regulatory Year t-2 , being the rate held in the PCFM as a fixed input value. The result of this calculation will be determined to be the revised value of TGIE for Regulatory Year t-2. The functionality of the PCFM processes this positive value as a tax liability allowance reduction and/or addition to the licensee's regulatory tax losses balance (see paragraph 4.10).

4.57 If the result of the calculation set out in paragraph 4.55 is zero or a negative value, then no positive benefit has been demonstrated and no tax clawback adjustment is applicable. In this case, the value of TGIE for Regulatory Year t-2 will be determined to be zero.

4.58 TGIE can only be zero or positive; the functionality of the PCFM will produce a negative revenue adjustment in relation to a positive TGIE value.

Re-performance of TGIE determinations

4.59 Ofgem will re-perform the determination of TGIE values for Regulatory Years prior to Regulatory Year t-2 to take account of:

- updated information reported by the licensee under the normal cost reporting information cycle;
- any restatements of cost information required under any provision of the licence; and
- any changes to the values referred to in paragraph 4.46 as a result of an Annual Iteration Process.

4.60 If a revised TGIE value is directed for a year earlier than Regulatory Year t-2, any resultant changes to recalculated base revenue figures for years earlier than Regulatory Year t-2 will, subject to a Time Value of Money Adjustment, be brought forward and reflected in the calculation of the term MOD to be directed for Regulatory Year t. For the avoidance of doubt, such a revision will not have any retrospective effect on a previously directed value of the term MOD.

Interaction with unutilised regulatory tax losses

4.61 If for any Regulatory Year a tax clawback adjustment is applicable to the licensee but the licensee has no modelled profits subject to tax, then the TGIE value calculated under paragraph 4.56 is grossed up with reference to the corporation tax rate for the licensee and added to the regulatory tax losses balance for the licensee. This is carried out automatically by functionality within the PCFM. This regulatory tax losses balance will be utilised against future taxable profit as set out in Part 5 below.

Direction of TGIE values

4.62 The Authority will direct revised TGIE values in respect of Regulatory Year t-2 and where appropriate earlier Regulatory Years, by 30 November in Regulatory Year t-1, having given the licensee at least 14 days' notice of the values that it proposes to direct.

4.63 If, for any reason, net debt or tax deductible interest figures submitted by the licensee or the RAV used in the PCFM or modelled interest costs that have been used in determining TGIE values are subject to amendment, the following procedure will be followed for the next Annual Iteration Process:

- Ofgem will re-perform the gearing level test and, if applicable, the positive tax benefit test, to determine whether any revised TGIE value should be determined and directed in respect of the Regulatory Year to which the amended figures relate. For this purpose, Ofgem will use a copy of the PCFM in its state following the last completed Annual Iteration Process to obtain an updated RAV value and modelled figure for tax deductible interest payable by the licensee.
- If a revised TGIE value is directed for a year earlier than Regulatory Year t-2, any resultant changes to recalculated base revenue figures for years earlier than Regulatory Year t-2 calculated under an Annual Iteration Process will, subject to a Time Value of Money Adjustment, be brought forward and reflected in the calculation of the term MOD to be directed for Regulatory Year t. For the avoidance of doubt, such a revision will not have any retrospective effect on a previously directed value of the term MOD.

4.64 The procedure for the Authority's direction of revised TGIE values is set out in Part D of Charge Restriction Condition 3C.

Part 4 - Processing of revised PCFM Variable Values under the Annual Iteration Process

TTE and TGIE values

4.65 Subject to paragraph 4.69, a positive TTE value will increase the recalculated base revenue figure for the Regulatory Year concerned by the same amount.

4.66 Subject to paragraph 4.69, a negative TTE value will decrease the recalculated base revenue figure for the Regulatory Year concerned by the equivalent amount.

4.67 Subject to paragraph 4.69, a positive TGIE value will decrease the recalculated base revenue figure for the Regulatory Year concerned by:

- the amount of the value[22]; and
- a ‘tax allowance on tax allowance’ factor calculated by functionality within the PCFM (see paragraph 4.6).

4.68 As noted at paragraph 4.58, TGIE values can only be zero or positive.

4.69 If there is any unutilised regulatory tax losses balance for the licensee, any change to recalculated base revenue under paragraph 4.65, 4.66 or 4.67 will be partially or fully abated to take account of that balance, and the regulatory tax losses balance held within the ED1 PCFM will be updated accordingly.

4.70 For the avoidance of doubt, regulatory tax losses are not carried back and offset against tax liability allowances for Regulatory Years earlier than the Regulatory Year to which the regulatory tax loss concerned is attributable.

[22] Subject to a price base adjustment factor applied under the PCFM functionality (see paragraph 1.5 in chapter 1).

5. Corporate debt allowed percentage cost - financial adjustment methodology

Overview

5.1 The licensee's Opening Base Revenue Allowances include amounts to cover the efficient cost of raising finance for the distribution business from external sources. This is commonly referred to as the 'cost of capital'. Cost of capital allowances are calculated as a percentage return on the licensee's Regulatory Asset Value (RAV). The percentage represents Ofgem's estimate of the weighted average cost of capital (WACC)[23] for the distribution business. The Vanilla WACC is determined using a pre-tax allowed cost of corporate debt percentage, a post-tax real cost of equity percentage and a notional gearing percentage weighting.

5.2 Under the RIIO-ED1 price control, the cost of equity and notional gearing percentages are fixed for the whole of the Price Control Period. However, the corporate debt cost percentage is updated on an annual basis with reference to a trailing average index of debt costs. The update is effected through the Annual Iteration Process.

5.3 The use of an indexed corporate debt percentage means that allowed revenues are appropriately updated to reflect debt market conditions. As a result, consumers will derive a benefit when debt costs fall whilst the licensee and its investors are provided with assurance that higher, efficiently incurred debt costs will be funded.

5.4 The basis for updating the cost of debt index percentage value by revising PCFM Variable Values for the licensee's allowed percentage cost of corporate debt ('CDE' values) is established in Charge Restriction Condition 3C (Specified financial adjustments). Charge Restriction Condition 3C requires revised CDE values to be determined in accordance with the methodology in this chapter.

Methodology for determining revised PCFM Variable Values for the cost of corporate debt

5.5 At the outset of the Price Control Period (1 April 2015), the CDE value for every Regulatory Year will be the pre-tax cost of debt percentage for the licensee previously published by Ofgem.

[23] see Glossary

5.6 Revised CDE values are to be derived using the pounds sterling indices of bonds issued by non-financial institutions which have a remaining maturity of 10 or more years contained in the Markit iBoxx® database of bond market data.

5.7 Revised CDE values for Regulatory Year t and later Regulatory Years will be determined in accordance with the methodology set out below and directed in respect of each Annual Iteration Process.

5.8 The steps to be followed for determining revised CDE values are:

Step 1

Establish the trading days period[24] to be used in relation to the particular Annual Iteration Process:

Annual Iteration Process taking place not later than:	**Trading days period**
30 November 2015	1 November 2005 to 31 October 2015
30 November 2016	1 November 2006 to 31 October 2016
30 November 2017	1 November 2007 to 31 October 2017
Et seq…….	Et seq…….

Step 2

For each day in the trading days period ascertained under Step 1, calculate the average of the annual yield figures from the following two iBoxx Sterling Non-Financial Indices:

(i). A 10+ index Markit iBoxx series reference: DE000A0JY837; and

(ii). BBB 10+ index Markit iBoxx series reference: DE000A0JZAH1

[24] Trading days as published in the Markit iBoxx® database

The above indices will be sourced from the Markit data service, to which Ofgem is subscribed. The A 10+ index covers bonds rated "A+", "A", and "A-" according to Markit iBoxx's published methodology and the BBB 10+ index covers bonds rated "BBB+", "BBB", and "BBB-". Each index only produces one annual yield figure for each day. Therefore, the average for each day is calculated as:

$$\frac{\text{“A 10+ index” annual yield figure for day} + \text{“BBB 10+ index” annual yield figure for day}}{2}$$

Step 3

For each day in the trading day period ascertained under Step 1, obtain a breakeven inflation figure for 10-year government-issued bonds by applying the following formula:

$$\pi = (1 + \mathrm{i})/(1 + \mathrm{r}) - 1$$

where:

π is the Ofgem imputed breakeven inflation figure.

i is the 'Yield From British Government Securities, 10 Year Nominal Zero Coupon' – series reference IUDMNZC; and

r is the 'Yield From British Government Securities, 10 Year Real Zero Coupon' – series reference IUDMRZC.

The above series will be sourced from the statistics page on the Bank of England's website.[25] In the event that the above data series does not include an entry that exactly matches the date from the Markit iBoxx series, the nearest older entry is to be used.

Step 4

For each day in the trading day period ascertained under Step 1, deflate the average of the annual yield figures obtained under Step 2 using the Bank of England's breakeven inflation figure obtained under Step 3, using the following formula:

$$CoD = (1 + iBoxx) / (1 + \pi) - 1$$

[25] http://www.bankofengland.co.uk

where:

CoD is the daily real deflated average of the annual yield figures;

$iBoxx$ is the average of the annual yield figures obtained under Step 2; and

π is the Ofgem imputed breakeven inflation figure obtained under Step 3.

This step converts the nominal bond yields in the iBoxx data to a real cost of debt value.

Step 5

Calculate the arithmetic average value of CoD across the trading days period ascertained under Step 1.

This average, expressed as a percentage, constitutes the revised PCFM Variable Value for the cost of corporate debt (CDE value) which will be directed and entered into the PCFM to two decimal places.

Non-availability of iBoxx or Bank of England data

5.9 If, for any reason, iBoxx data or Bank of England data is unavailable for an entire trading days period in time to determine revised PCFM Variable Values for the cost of corporate debt for any Annual Iteration Process, then for that Annual Iteration Process only, the trading days period concerned shall be deemed to have ended on the last trading day for which data has been published. If the data concerned is subsequently published, revised PCFM Variable Values for the affected Regulatory Years will be directed.

5.10 If, for any reason, the iBoxx or Bank of England series identified above ceases to be published, or if there is a material change in the basis of those indices, Ofgem will consult on alternatives, as well as on any reconciliation that may need to be undertaken between the above series and any replacements.

Use of revised PCFM Variable Values in the Annual Iteration Process

5.11 The Authority will direct revised CDE values by no later than 30 November in each Regulatory Year t-1 in accordance with Part D of Charge Restriction Condition 3C. Notice of proposed revised values will be given to the licensee at least 14 days before the date of the direction.

5.12 PCFM Variable Values for the cost of corporate debt will be directed together with all other types of PCFM Variable Value. Further information on the process is given in chapters 1 and 2.

5.13 The data and spreadsheet used to calculate revised CDE values will be published on the Ofgem website.

6. Totex Incentive Mechanism – financial adjustment methodology

6.1 The licensee's Opening Base Revenue Allowances will have been modelled on the basis that actual Totex[26] expenditure levels are expected to equal allowed Totex expenditure levels (allowances). If actual (outturn) expenditure differs from allowances, for any Regulatory Year during the Price Control Period, the Totex Incentive Mechanism (TIM) provides for a defined sharing of the incremental amount (whether an overspend or under spend) between consumers and the licensee.

6.2 The PCFM contains values for both actual Totex expenditure and allowed Totex expenditure levels which, as mentioned above, are initially equal to each other. Both the actual and allowed expenditure values contained in the PCFM can be varied for the purposes of applying the TIM through the Annual Iteration Process.

Actual Totex expenditure

6.3 Actual Totex expenditure is divided into seven sub-divisions to facilitate varying tax pool treatments under the Annual Iteration Process calculations (see Table 6.2). This chapter sets out the process by which the actual Totex expenditure values in the PCFM can be revised. It also describes the way in which revised figures for Totex flow into the calculation of the term MOD_t.

6.4 Charge Restriction Condition 3B (Determination of PCFM Variable Values relating to actual Totex expenditure for Totex Incentive Mechanism Adjustments) provides for the Authority to determine revised PCFM Variable Values for the licensee relating to actual Totex expenditure levels. It also sets out the procedures for the direction of those values so that they can be used for the Annual Iteration Process.

[26] See Glossary

Allowed Totex expenditure

6.5 The procedures for determining and directing revised PCFM Variable Values relating to allowed Totex expenditure levels are covered in the chapters of this handbook shown in Table 6.1 below:

Table 6.1 – Charge Restriction Conditions with provisions to revise PCFM Variable Values relating to allowed Totex expenditure levels

Charge Restriction Condition	PCFM Variable Value	Relating to	Handbook chapter
CRC 3D	IRM	Innovation roll-out expenditure	12
CRC 3F	UCHVP UCEPS UCSSW	High value projects Enhanced physical site security costs Specified street works	7
CRC 3E	SMAE	Smart metering roll-out	8
CRC 3G	LRRC	Load related reopener	9
CRC 3J	VAA	Visual amenity (undergrounding)	10
CRC 3H	WSCC	Worst served customers	11
CRC 3K[27]	RE	Rail electrification	12A

Description of the Totex Incentive Mechanism (TIM)

6.6 The TIM applies adjustments to the Totex figure used in the fast/slow money modelling of recalculated base revenue figures under the Annual Iteration Process. The adjustments reflect the amount of under or over expenditure by the licensee against Totex allowances and the relevant Totex Incentive Strength Rate (incentive strength) for the licensee. The incentive strength is a percentage figure specified in Charge Restriction Condition 3B. It represents the post-tax percentage that the licensee bears in respect of an overspend against allowances or retains in respect of an under spend against allowances. The adjustment that is made to the Totex figures is the Funding Adjustment Rate (often called the 'sharing factor') which is calculated as (1 – incentive strength). Applying the Funding Adjustment Rate to the over (or under spend) gives the amount that is added to (or subtracted from) the Totex allowances that were used to calculate Opening Base Revenue Allowances. Wherever the term "Totex Incentive Mechanism Adjustment" is used in the Charge

[27] Applicable to WPD group licensees only – see paragraph 12A.1 of chapter 12A.

Restriction Conditions, it means an adjustment under the mechanism described in this paragraph.

6.7 The TIM uses the actual Totex expenditure values reported to Ofgem by 31 July following a particular Regulatory Year t-2 (subject to any revisions that may be required for corrections to data or for expenditure that is not regarded as efficient) and adjusts allowed revenue in Regulatory Year t via the MOD term. The incentive mechanism therefore operates with a two year lag.

6.8 For the visual amenity (undergrounding) and worst served customers categories, functionality in the PCFM automatically sets actual Totex expenditure levels to be equal to allowed expenditure levels (see chapters 10 and 11). This has the effect of neutralising the impact of the TIM for these categories of expenditure.

6.9 Totex, once ascertained under the TIM, is apportioned using the Totex Capitalisation Rate(s) for the licensee as:

- fast money – flowing directly to the recalculated base revenue figure for the Regulatory Year to which the allowed expenditure relates; and
- slow money - additions to the licensee's RAV in the Regulatory Year to which the allowed expenditure relates; the return on RAV and depreciation flows to the recalculated base revenue figure for the Regulatory year.

6.10 The Totex Capitalisation Rate for the licensee is specified at Appendix 1 to Charge Restriction Condition 3B and is a fixed input value for the licensee in the PCFM. The rate is fixed for the Price Control Period.

6.11 Under the Annual Iteration Process, the effects of this modelling treatment (including any ancillary effects such as the impact on tax allowances) are reflected in the value of the term MOD_t.

Totex Incentive Mechanism - illustrative examples

6.12 Basic, illustrative examples of the calculation approach are set out below:

Opening position:

allowed Totex expenditure:	110
assumed actual Totex expenditure:	110
over/under spend:	nil
Totex amount for fast/slow money treatment	110

Outturn position – scenario 1:

allowed Totex expenditure:	110
actual Totex expenditure	90

under spend:	20
incentive strength say 70% (or 0.7)	
Totex adjustment (1 - 0.7) X 20	6
Totex amount for fast/slow money treatment 110 – 6	104

Outturn position – scenario 2:

allowed Totex expenditure:	110
actual Totex expenditure	120
overspend:	10
incentive strength say 70% (or 0.7)	
Totex adjustment (1 – 0.7) X 10	3
Totex amount for fast/slow money treatment 110 + 3	113

6.13 The reduced Totex amount for fast/slow money treatment in scenario 1 represents a clawback of part of the under spend achieved by the licensee to benefit consumers. The increased Totex amount for fast/slow money treatment in scenario 2 represents a reimbursement of part of the overspend incurred by the licensee.

Application of the TIM under the Annual Iteration Process

6.14 The opening values for actual Totex expenditure contained in the PCFM will be revised under the methodology set out in this chapter to reflect outturn values (in 2012/13 prices) reported by the licensee in its annual cost reporting submission, subject to review by Ofgem. The normal revision cycle will be:-

Regulatory Year t-2:	Totex expenditure incurred
Regulatory Year t-1:	Outturn expenditure levels reported to Ofgem by 31 July
Regulatory Year t-1:	31 October – cut off date for making revisions (that may be required for corrections of data or for expenditure that is not regarded as efficient) to outturn expenditure levels to be taken account of in that year's Annual Iteration Process
Regulatory Year t-1:	Revised PCFM Variable Values for actual Totex expenditure determined and directed by the Authority by 30 November or as soon as reasonably practicable practicable thereafter
	Note that revised PCFM Variable Values for categories of allowed Totex expenditure will also have been determined/directed by 30 November where that is

	required by relevant Charge Restriction Conditions and associated chapters in this handbook (see Table 6.1).
Regulatory Year t-1:	Value for MOD_t directed by the Authority by 30 November
Regulatory Year t:	Value for MOD_t effective in formula for licensee's Allowed Distribution Network Revenue.

6.15 The Authority can determine and direct revised PCFM Variable Values for actual Totex expenditure for years earlier than Regulatory Year t-2 for use in any Annual Iteration Process, but only where necessary to address a restatement of, or correction to, price control cost information submitted by the licensee.

6.16 Allowed Totex expenditure levels will be revised in accordance with the provisions of applicable scheme licence conditions and the associated methodologies in this handbook. In instances where allowed Totex expenditure levels are revised for Regulatory Year t-1 or later, the PCFM will automatically update expected actual Totex expenditure levels to equivalent amounts for those years. This is consistent with the modelling rationale described in the opening paragraph of this chapter.

6.17 It should be noted that:

- each Annual Iteration Process re-runs the TIM calculations for each Regulatory Year up to Regulatory Year t-2 (for later years the TIM is neutral – see paragraph 6.16);
- the outstanding effect of those calculations is reflected in the value of MOD_t; and
- the PCFM works in 2012/13 price base, and applies Time Value of Money Adjustments to ensure that the effect of PCFM Variable Value revisions are NPV neutral with respect to Regulatory Year t.

Total expenditure (Totex)

6.18 In summary Totex consists of all expenditure by the licensee with the exception of:

- costs relating to de minimis activities (defined in Standard Condition 29 of the licence);
- costs relating to Directly Remunerated Services;
- pension deficit repair payments relating to the Established Deficit and all post 1 April 2004 unfunded early retirement deficiency costs (ERDC);
- the non-cash element of current service pension costs charged to the income statement in accordance with accounting standards;
- statutory or regulatory depreciation and amortisation;
- profit margins from related parties (except where permitted);

- costs relating to rebranding a company's assets or vehicles following a change of trading name or logo;
- fines and penalties incurred by the licensee (including all tax penalties, fines and interest) except if Traffic Management Act penalty costs can be shown to be efficient;
- compensation payments made in relation to standards of performance;
- bad debt costs and recoveries (which are subject to separate review);
- costs relating to the network innovation allowance and network innovation competition;
- costs reported other than on a normal accruals basis;
- costs relating to pass-through items; and
- interest, other financing and corporation tax costs.

6.19 Further details on the reporting of expenditure items which are eligible for Totex treatment is given in the Regulatory instructions and guidance (RIGs) referred to in Standard Condition 46 (Regulatory instructions and guidance) of the licence.

6.20 It should also be noted that:

- Pension deficit repair payments relating to any incremental deficit (ie not part of the Established Deficit) are considered to be part of the licensee's Totex.
- Customer contributions and other proceeds received (including from legal and insurance claims but excluding asset disposal proceeds) that relate to the distribution business are treated as an offset to Totex expenditure, unless specifically subject to different treatment under the RIGs.
- Charge Restriction Conditions 5C (Directly Remunerated Services) and 5F (Services for managing Relevant Theft of Electricity from the Distribution System) provide for the licensee to deduct amounts from its reported totals for Actual controllable opex expenditure (ACO values – see Table 6.2 below) for the purpose of sharing income specified in those conditions with consumers via the TIM mechanism. Any such reductions will flow into the RAV balance for the licensee held in the PCFM.
- Asset disposal proceeds are, subject to the licensee's capitalisation rate, deducted directly from the licensee's RAV balance. Asset disposal levels have been forecast for the RIIO-ED1 Price Control Period and a true up to outturn levels will be taken into account in the calculation of base revenue allowances for the RIIO-ED2 price control.

Determination of PCFM Variable Value revisions for actual Totex expenditure

6.21 Following a review by Ofgem, the Authority will, by 30 November in each Regulatory Year t-1, determine that the PCFM Variable Values for Regulatory Year t-2, shown in the first column of Table 6.2 below, should be revised to match the equivalent actual expenditure values in the licensee's annual cost reporting submission (after deflation to 2012/13 prices and any necessary adjustments).

6.22 The Authority can also determine and direct revised PCFM Variable Values for actual Totex expenditure for years earlier than Regulatory Year t-2 where that is necessary to address a restatement of, or correction to, price control cost information submitted by the licensee including costs amended following any efficiency review by Ofgem.

Table 6.2 – PCFM Variable Values for actual Totex

PCFM Variable Value	Totex sub-division
ALC	Actual load-related capex expenditure
ANLR	Actual non-load-related capex expenditure - asset replacement
ANLO	Actual non-load-related capex expenditure - asset replacement
AFE	Actual faults expenditure
ARP	Actual 100% 'revenue pool' expenditure
ACO	Actual controllable opex expenditure
TRE	Actual tree cutting expenditure

6.23 Each of the terms set out in column 2 of Table 6.2 means the value shown against that term name in the licensee's completed annual cost reporting return for the relevant Regulatory Year submitted to Ofgem under the RIGs.

Notification and direction of revised PCFM Variable Values

6.24 The PCFM is a constituent part of Charge Restriction Condition 4A (Governance of ED1 Price Control Financial Instruments). It has an input area for each licensee containing both fixed values and variable values. The variable values relating to actual Totex expenditure are shown in the PCFM Variable Values table 6.2 above.

6.25 During each Regulatory Year t-1, the Authority will determine whether any PCFM Variable Values for the licensee relating to actual Totex expenditure should be revised. Part D of Charge Restriction Condition 3C, requires the Authority to give the licensee at least 14 days' notice of any such proposed revisions, to allow for representations or objections. The Authority is required to have due regard to any representations or objections received from the licensee and to give reasons for its decisions in relation to them.

6.26 The Authority is required to direct any PCFM Variable Value revisions by 30 November in Regulatory Year t-1, so the notice of proposed values must be given no later than 15 November in the same year. The Authority will give notice of the proposed values as soon as practicably possible in Regulatory Year t-1.

6.27 The Authority will then carry out the Annual Iteration Process in accordance with Special Condition 4B (see Chapter 1).

7. Uncertain costs allowed expenditure - financial adjustment methodology

Part 1 - Overview

7.1 At the outset of the Price Control Period, levels of allowed expenditure for some distribution activities were set on a provisional basis because of uncertainties surrounding requirements or cost levels. The licensee's Opening Base Revenue Allowances were modelled using these provisional amounts.

7.2 Charge Restriction Condition CRC 3F (Arrangements for the recovery of uncertain costs) sets out the basis on which opening levels of allowed expenditure on uncertain cost activities can be revised through 'relevant adjustments'. It also sets out how the PCFM Variable Value associated with each uncertain cost activity should be revised.

7.3 At the outset of the RIIO-ED1 Price Control Period on 1 April 2015, the PCFM Variable Value for the licensee for each uncertain cost activity for each Regulatory Year of the Price Control Period was set to equal the level of allowed expenditure referred to in paragraph 7.1. These were the levels that were used to derive the licensee's Opening Base Revenue Allowances and they are set out against the licensee's name in the tables contained in Appendices 1, 2 and 3 to CRC 3F. The PCFM Variable Value for each uncertain cost category can be revised to reflect relevant adjustments to allowed expenditure levels under the provisions of CRC 3F and this chapter.

7.4 The categories of uncertain cost activities together with their associated PCFM Variable Values are shown in Table 7.1 below. Under the Annual Iteration Process, allowed expenditure levels for uncertain cost activities, as updated via PCFM Variable Value revisions, interact with actual expenditure information so that appropriate Totex Incentive mechanism adjustments are reflected in the calculation of values for the term MOD.

Table 7.1 – Uncertain cost categories

Uncertain cost activity	PCFM Variable Value name	Charge Restriction Condition
High Value Projects	UCHVP	CRC 3F
Enhanced Physical Site Security	UCEPS	
Specified Street Works	UCSSW	

7.5 PCFM Variable Values relating to uncertain cost activities are stated in 2012/13 prices, consistent with the price base used in the PCFM and the values for the term MOD. The allocation of allowed expenditure for uncertain cost activities into the Totex sub-divisions referred to in Table 6.2 in Chapter 6 is handled automatically under the Annual Iteration Process using fixed attribution rates contained in the PCFM.

7.6 CRC 3F provides for:

- the licensee to propose revisions to levels of allowed expenditure ('relevant adjustments'), but only during an application window specified in CRC 3F (see paragraph 7.7);
- the Authority to propose relevant adjustments, in relation to High Value Projects only, during a notice window specified in CRC 3F (see paragraph 7.8);
- the determination of relevant adjustments by the Authority; and
- the deeming of relevant adjustments in certain circumstances,

in respect of each uncertain cost activity.

7.7 The application window during which the licensee can propose relevant adjustments runs from 1 May 2019 to 31 May 2019.

7.8 The notice window during which the Authority can give notice of proposed relevant adjustments in respect of High Value Projects runs from 1 December 2023 to 31 December 2023. This window is after the end of the Price Control Period whose last day is 31 March 2023.

7.9 CRC 3F and this chapter set out the basis on which relevant adjustments can be proposed by the licensee and the Authority. However, this chapter only deals with:

(a) determinations with respect to relevant adjustments proposed by the licensee; and

(b) the determination and direction of revised PCFM Variable Values to give effect to determinations made under subparagraph (a).

7.10 Relevant adjustments proposed by the Authority will be addressed through adjustment mechanisms to be included in the RIIO-ED2 price control arrangements for the licensee and are not dealt with further under this chapter.

Determinations and directions with respect to relevant adjustments proposed by the licensee

7.11 The Authority may determine relevant adjustments to the licensee's levels of allowed expenditure with respect to proposals made by the licensee within four months of the close of the application window referred to in paragraph 7.7 - ie by 30 September 2019. The determination of relevant adjustments will be made in accordance with the methodologies set out in parts 2, 3 and 4, as applicable, of this chapter. The Authority will notify the licensee of any determination it has made within 14 days of making it.

7.12 If the Authority has not determined a relevant adjustment in relation to a proposal duly made by the licensee within four months of the close of the application window, and the proposal has not been withdrawn, then the relevant adjustment will be deemed to have been made.

7.13 CRC 3F also provides for the associated PCFM Variable Values to be revised for appropriate Regulatory Years in the Price Control Period so that relevant adjustments are reflected in the recalculation of base revenue figures for the licensee under the Annual Iteration Process for the ED1 Price Control Financial Model. It also sets out the procedures for the direction of revised PCFM Variable Values by the Authority.

General principles applicable to uncertain cost adjustment mechanisms

7.14 CRC 3F states that proposed changes to the levels of allowed expenditure on uncertain cost activities must:

- be based on information about actual or forecast levels of efficient expenditure requirements that was not available when the licensee's Opening Base Revenue Allowances were derived;
- take account of any relevant adjustments previously determined under CRC 3F;
- constitute a material amount as set out against the licensee's name in the relevant table in Appendix 1, 2 or 3 to CRC 3F;
- relate to costs incurred or expected to be incurred after 1 April 2015; and
- constitute an adjustment to allowed expenditure which cannot be made under the provisions of any other condition of the licence.

7.15 The stipulation that proposals must take account of any previously determined relevant adjustments is intended to ensure that relevant costs are not ignored on the one hand, or double counted on the other.

7.16 The Authority will determine whether any PCFM Variable Values should be revised for the purposes of implementing relevant adjustments by 31 October 2019. The PCFM Variable Value for any particular Regulatory Year, as revised represents the total amount of allowed Totex expenditure (in 2012/13 prices) for the uncertain cost activity concerned for that Regulatory Year.

Part 2 – Methodology for determining relevant adjustments in respect of High Value Project activity

The uncertainty mechanism for High Value Projects activity

7.17 For the purposes of CRC 3F and this chapter, the term High Value Project means a scheme of works whose overall cost will be £25m or more (in 2012/13 prices) and in respect of which there is no other mechanism for the adjustment of allowed expenditure levels during the Price Control Period.

7.18 Some High Value Projects were taken into account in the calculation of the licensee's Opening Base Revenue Allowances. The uncertainty mechanism does not provide for any further adjustment to the licensee's allowed expenditure in respect of these projects, but they remain relevant in two respects:

(i) Allowed expenditure (included in Opening Base Revenue Allowances) and actual efficient expenditure levels for these High Value Projects are taken into account in assessing whether the overall materiality threshold has been reached.

(ii) The Authority will review the licensee's achievement of outputs associated with these High Value Projects when determining any relevant adjustment proposed by the licensee under CRC 3F.

Overall materiality threshold

7.19 An overall materiality threshold applies in respect of relevant adjustments for High Value Projects. The materiality threshold for the licensee, in 2012/13 prices, is set out against the licensee's name in the first table in Appendix 1 to CRC 3F.

7.20 The amount to be tested against the materiality threshold will be determined in 2012/13 prices as:

(i) the total of the licensee's actual and forecast efficient expenditure on:

- High Value Projects included in the calculation of the licensee's Opening Base revenue Allowances; and

- additional High Value Projects included in any proposal by the licensee for a relevant adjustment,

for all Regulatory Years in the Price Control Period

less

(ii) the total amount of allowed expenditure included in the calculation of the licensee's Opening Base Revenue Allowances in respect of High Value Projects,

for all Regulatory Years in the Price Control Period.

7.21 If the materiality threshold is passed, it is not taken further into account in the determination of relevant adjustments to allowed expenditure levels. If the materiality threshold is not passed, then any relevant adjustment proposal will be rejected.

Determination of a relevant adjustment proposed by the licensee

7.22 If the Authority receives notice of a proposed relevant adjustment from the licensee in respect of High Values Projects it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

Determination steps

(i) The Authority will check whether the notice has been received during the application window referred to in paragraph 7.7. If the notice has been received before 1 May 2019 the Authority will notify the licensee that the notice has been submitted too early and should be resubmitted during May 2019. If the notice has been received after 31 May 2019 the Authority will notify the licensee that the notice has been received too late and that a relevant adjustment will not be determined.

(ii) The Authority will check in respect of each of the projects included in the relevant adjustment proposal whether:

a. it has an overall cost of £25m or more;

b. each of the requirements set out in paragraphs 3F.7 and 3F.8 of CRC 3F have been met (except for the requirement in respect of a material amount – see step (ivi));

c. the proposal by the licensee represents an efficient level of expenditure;

d. a need for the project to be carried out has been established; and

e. measurable outputs for the project have been identified.

(iii) The Authority will decide whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required it will call for that information from the licensee, setting a deadline for submission that takes account of:

a. the amount of time that the licensee will reasonably require to compile the information;

b. the four month period for determinations referred to in paragraph 3F.17 of CRC 3F; and

c. the need to consult the licensee on its proposed determination.

(iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs 7.19 and 7.20. If it has not, the proposed relevant adjustment will be rejected.

(v) The Authority will consider whether the outputs associated with the High Value Projects included in the calculation of Opening base Revenue allowances have been or will be achieved.

(vi) Having carried out steps (i) to (v) above, the Authority will provisionally determine whether to:

a. reject the relevant adjustment proposed by the licensee;

b. confirm the relevant adjustment proposed by the licensee; or

c. amend the relevant adjustment proposed by the licensee.

If the Authority decides to amend or confirm the licensee's proposal it will, in respect of each of the projects included in the relevant adjustment proposal, provisionally determine the adjustments to allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied.

(vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.

(vii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

7.23 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of High Value Projects will specify:

(a) the Regulatory Years to which the determination applies; and

(b) the revised total amounts of allowed Totex expenditure (in 2012/13 prices) for each of the specified years.

7.24 If the Authority receives notice of a proposed relevant adjustment from the licensee in respect of High Values Projects and does not make a relevant adjustment determination within four months of the close of the application window (ie by 30 September 2019), and the proposal has not been withdrawn, then paragraph 3F.17 of CRC 3F stipulates that the adjustments will be deemed to have been made.

7.25 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCHVP values under part 5 of this chapter.

Part 3 – Methodology for determining relevant adjustments in respect of Enhanced Physical Site Security works

The uncertainty mechanism for Enhanced Physical Site Security works

7.26 For the purposes of CRC 3F and this chapter, the term Enhanced Physical Site Security activity means works carried out for the purposes of implementing formal recommendations or requirement of the Secretary of State to enhance the physical security of sites within the licensee's Distribution System.

7.27 Requirements for Enhanced Physical site Security works at some sites were taken into account in the calculation of the licensee's Opening Base Revenue Allowances. The uncertainty mechanism does not provide for any further adjustment to the licensee's allowed expenditure in the Price Control Period in respect of these sites.

Overall materiality threshold

7.28 An overall materiality threshold applies in respect of relevant adjustments for Enhanced Physical Site Security works. The materiality threshold for the licensee, in 2012/13 prices, is set out against the licensee's name in the table in Appendix 2 to CRC 3F.

7.29 If the materiality threshold is passed, it is not taken further into account in the determination of relevant adjustments to allowed expenditure levels. If the materiality threshold is not passed, then any relevant adjustment proposal will be rejected. This is without prejudice to any review of costs 'logged up' by the licensee for consideration in respect of arrangements for the RIIO-ED2 price control.

Determination of a relevant adjustment proposed by the licensee

7.30 If the Authority receives notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security works it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

Determination steps

(i) The Authority will check whether the notice has been received during the application window referred to in paragraph 7.7. If the notice has been received before 1 May 2019 the Authority will notify the licensee that the notice has been submitted too early and should be resubmitted during May 2019. If the notice has been received after 31

May 2019 the Authority will notify the licensee that the notice has been received too late and that a relevant adjustment will not be determined.

(ii) The Authority will check in respect of each of the sites included in the relevant adjustment proposal whether:

a. each of the requirements set out in paragraphs 3F.7 and 3F.8 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));

b. works that have been carried out, or that are to be carried out, meet the security requirements specified in the relevant recommendation or requirement of the Secretary of State; and

c. works that have been carried out, or that are to be carried out, represent an efficient level of expenditure.

In making the checks at points 'a.', 'b.' and 'c.', the Authority will take into account the results of any audit of the licensee's Enhanced Physical Site Security activity and the results of any benchmarking review that the Authority has carried out.

(iii) The Authority will decide whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required it will call for that information from the licensee, setting a deadline for submission that takes account of:

a. the amount of time that the licensee will reasonably require to compile the information;

b. the four month period for determinations referred to in paragraph 3F.17 of CRC 3F; and

c. the need to consult the licensee on its proposed determination.

(iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph 7.28. If it has not, the proposed relevant adjustment will be rejected.

(v) Having carried out steps (i) to (iv) above, the Authority will provisionally determine whether to:

a. reject the relevant adjustment proposed by the licensee;

b. confirm the relevant adjustment proposed by the licensee; or

c. amend the relevant adjustment proposed by the licensee.

If the Authority decides to amend or confirm the licensee's proposal it will, in respect of each of the sites included in the relevant adjustment proposal, provisionally determine the adjustments to allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied.

(vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.

(vii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

7.31 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Enhanced Physical Site Security works will specify:

(a) the Regulatory Years to which the determination applies; and

(b) the revised total amounts of allowed expenditure (in 2012/13 prices) for each of the specified years.

7.32 If the Authority receives notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security works and does not make a relevant adjustment determination within four months of the close of the application window (ie by 30 September 2019), and the proposal has not been withdrawn, then paragraph 3F.17 of CRC 3F stipulates that the adjustments will be deemed to have been made.

7.33 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCEPS values under part 5 of this chapter.

Part 4 – Methodology for determining relevant adjustments in respect of Specified Street Works Costs

The uncertainty mechanism for Specified Street Works Costs

7.34 For the purposes of CRC 3F and this chapter, the term Specified Street Works Costs means costs incurred, or expected to be incurred, by the licensee in complying with obligations or requirements arising under any order or regulations made under Part 3 of the Traffic Management Act 2004 (or, in Scotland, the Transport (Scotland) Act 2005) that impose a permit scheme and comprise:

(a) permit fee costs;

(b) set up costs for permit scheme management systems; and

(c) additional administrative costs arising from the introduction of permit schemes.

7.35 The uncertainty mechanism provides for relevant adjustments in respect of efficient costs that were not included in the calculation of the licensee's Opening base Revenue Allowances.

Overall materiality threshold

7.36 An overall materiality threshold applies in respect of relevant adjustments for Specified Street Works Costs. The materiality threshold for the licensee, in 2012/13 prices, is set out against the licensee's name in the table in Appendix 3 to CRC 3F.

7.37 If the materiality threshold is passed, it is not taken further into account in the determination of relevant adjustments to allowed expenditure levels. If the materiality threshold is not passed, then any relevant adjustment proposal will be rejected. This is without prejudice to any consideration of costs in respect of arrangements for the RIIO-ED2 price control.

Determination of a relevant adjustment proposed by the licensee

7.38 If the Authority receives notice of a proposed relevant adjustment from the licensee in respect of Specified street Work Costs it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

Determination steps

(i) The Authority will check whether the notice has been received during the application window referred to in paragraph 7.7. If the notice has been received before 1 May 2019 the Authority will notify the licensee that the notice has been submitted too early and should be resubmitted during May 2019. If the notice has been received after 31 May 2019 the Authority will notify the licensee that the notice has been received too late and that a relevant adjustment will not be determined.

(ii) The Authority will check whether

a. each of the requirements set out in paragraphs 3F.7 and 3F.8 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (ivi));

b. the licensee has, or will be able to, provide 12 months' worth of costs data to support its proposal; and

c. the proposal by the licensee represents an efficient level of expenditure.

(iii) The Authority will decide whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required it will call for that information from the licensee, setting a deadline for submission that takes account of:

a. the amount of time that the licensee will reasonably require to compile the information;

b. the four month period for determinations referred to in paragraph 3F.17 of CRC 3F; and

c. the need to consult the licensee on its proposed determination.

(iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph 7.36. If it has not, the proposed relevant adjustment will be rejected.

(v) In reviewing the level of permit fee costs included in any relevant adjustment proposal the Authority will take into account:

a. the number of permits to that the licensee has been or will be required to obtain in respect of works schemes; and

b. the costs of permits that the licensee has been or will be required to obtain.

(vi) In reviewing the level of system set up costs and additional administration costs included in any relevant adjustment proposal the Authority will take into account the results of any benchmarking or other comparative analysis that is has carried out or commissioned.

(vii) Having carried out steps (i) to (vi) above, the Authority will provisionally determine whether to:

a. reject the relevant adjustment proposed by the licensee;

b. confirm the relevant adjustment proposed by the licensee; or

c. amend the relevant adjustment proposed by the licensee.

If the Authority decides to amend or confirm the licensee's proposal it will provisionally determine the adjustments to the licensee's allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied.

(viii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.

(ix) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

7.39 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Specified Street Works Costs will specify:

(a) the Regulatory Years to which the determination applies; and

(b) the revised total amounts of allowed Totex expenditure (in 2012/13 prices) for each of the specified years.

7.40 If the Authority receives notice of a proposed relevant adjustment from the licensee in respect of Specified Street Works Costs and does not make a relevant adjustment determination within four months of the close of the application window (ie by 30 September 2019), and the proposal has not been withdrawn, then paragraph 3F.17 of CRC 3F stipulates that the adjustments will be deemed to have been made.

7.41 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSSW values under part 5 of this chapter.

Part 5 – Determination, notification and direction of revised PCFM Variable Values for uncertain cost activities

7.42 Charge Restriction Condition 3F specifies that the PCFM Variable Value for the licensee for each uncertain cost activity as at 1 April 2015 (ie before any revisions to PCFM Variable Values have been made) for each Regulatory Year of the Price Control Period will be equal to the level of allowed Totex expenditure that was used in the calculation of the licensee's Opening Base Revenue Allowances. It also specifies that revised PCFM Variable Values relating to uncertain cost activities will be directed by the Authority by 30 November in Regulatory Year 2019/20 (ie by 30 November 2019).

Determination of revised PCFM Variable Values

7.43 On or before 31 October 2019, Ofgem will check to see whether any determinations of relevant adjustment have been made or have been deemed to have been made in respect of

(a) High Value Projects;

(b) Enhanced Physical Site Security works; and

(c) Specified Street Works Costs,

that change the level of allowed expenditure for the licensee and that have not previously been taken fully into account in the determination of revisions to the associated PCFM Variable Value for the Regulatory Year or Years concerned.

7.44 If any determination of a relevant adjustment has not previously been taken into account, the Authority will determine that the associated PCFM Variable Value (as set out in the next paragraph) for the Regulatory Year or Years concerned is to be revised so that it equals the revised total amount of allowed Totex expenditure (in 2012/13 prices) specified in the relevant adjustment determination.

7.45 The PCFM Variable Values referred to in paragraph 7.44 are:

(a) UCHVP values in respect of High Value Projects;

(b) UCEPS values in respect of Enhanced Physical Site Security works; and

(c) UCSSW values in respect of Specified Street Works Costs.

Notification and direction of revised PCFM Variable Values

7.46 The Authority will give notice of any revisions to UCHVP, UCEPS and UCSSW values that it proposes to direct by 15 November in Regulatory Year 2019/20, being at least 14 days before the deadline date of 30 November for the direction of revised PCFM Variable Values. The notice will confirm that:

- any revised PCFM Variable Value determinations have been made in accordance with Part B of Charge Restriction Condition 3F, which cross refers to this chapter of the ED1 Price Control Financial Handbook; and
- the licensee has 14 days from the date of the notice in which to make any representations concerning the proposed PCFM Variable Value revisions.

7.47 The Authority is required to have due regard to any representations or objections made by the licensee and to give its reasons for any decisions in relation to them.

7.48 The Authority will only direct PCFM Variable Value revisions for uncertain cost activities in accordance with the provisions of CRC 3F. However, the overall direction of PCFM Variable Value revisions in each Regulatory Year t-1 will include a copy of the PCFM Variable Values Table for the licensee showing the state of all PCFM Variable Values including those relating to uncertain cost activities.

Delay in direction of revised PCFM Variable Values

7.49 If the procedures set out in Charge Restriction Condition 3F and this chapter call for the Authority to direct revised PCFM Variable Values for one or more uncertain cost categories by 30 November 2019, and the Authority does not make such a direction, then Charge Restriction Condition 3F requires that the values concerned should be directed by the Authority as soon as is reasonably practicable, to facilitate the notification and direction of the value of the term MOD_t for the licensee under Charge Restriction Condition 4B (Annual Iteration Process for the PCFM).

8. Smart Meter Roll-out - financial adjustment methodology

Overview

8.1 A large scale roll out of smart meters will be carried out by electricity suppliers during the Price Control Period. The licensee will be required to participate ('intervene') in a significant number of installations where work on distribution system assets is required to facilitate the fitting of smart meters. The provisions of Charge Restriction Condition CRC 3E (Smart Meter Roll-out Costs) and the methodology in this chapter will ensure that the licensee's level of allowed Totex expenditure for smart meter roll-out work is commensurate with efficient management of that activity.

8.2 At the outset of the Price Control Period, levels of allowed Totex expenditure for Smart Meter Roll-out were set on a provisional basis because of uncertainties surrounding the number of installations that would take place and the number of installations where the licensee would be required to intervene. The licensee's Opening Base Revenue Allowances were modelled using these provisional amounts.

8.3 At the outset of the Price Control Period on 1 April 2015, SMAE values for the licensee for each Regulatory Year of the Price Control Period were set to equal the level of allowed Totex expenditure referred to in paragraph 8.2. These were the levels that were used in calculating the licensee's Opening Base Revenue Allowances and they are set out against the licensee's name in Table 1 in Part A of CRC 3E.

8.4 CRC 3E sets out the basis on which opening levels of allowed expenditure on Smart Meter Roll-out are be revised using a formula that is set out in Part B of that condition. The formula incorporates a tapering mechanism to incentivise the licensee to minimise intervention levels and to recognise economies of scale.

8.5 CRC 3E also sets out how the PCFM Variable Values associated with Smart Meter Roll-out (SAME values) are to be revised. Under the Annual Iteration Process, allowed expenditure levels on Smart Meter Roll-out, as updated via SMAE value revisions, interact with actual expenditure information so that appropriate Totex Incentive mechanism adjustments are reflected in the calculation of values for the term MOD (see chapter 6).

Determination, notification and direction of revised PCFM Variable Values for Smart meter roll-out activity (SMAE values)

Determination of revised SMAE values

8.6 The formula for the licensee's allowed Totex expenditure levels for Smart Meter Roll-out (contained in Part B of CRC 3E and referred to in paragraph 8.4 above) provides an updated level of allowed expenditure for each Regulatory Year t-

2 (see note on temporal convention in chapter 1). The calculation makes use of two variables:

(a) the total number of smart meter installations in the licensee's Distribution Services Area during Regulatory Year t-2; and

(b) the number of smart meter installations where the licensee was required to intervene.

The numbers referred to in subparagraphs 9a) and (b) will be reported by the licensee in its annual reporting to Ofgem under the RIGs.

8.7 The revised levels of allowed expenditure on Smart Meter Roll-out for the licensee, calculated using the formula contained in Part B of CRC 3E, will be determined by the Authority to be revised SMAE values for the licensee for the Regulatory Years concerned.

Timing of determinations of revised SMAE values

8.8 The first Regulatory Year of the Price Control Period is Regulatory Year 2015/16. The licensee will report smart meter installation numbers for Regulatory Year 2015/16 to Ofgem by 31 July 2016. Therefore, subject to the notice requirements set out below, the first determination and direction of a revised SMAE value for the licensee will take place by 30 November 2016 for the purposes of the Annual Iteration Process that will take place by 30 November 2016. Subsequent determinations will routinely follow a similar pattern as shown in Table 8.1 below.

Table 8.1 – Routine for determination of revised SMAE values

Regulatory Year t-2 during which activity takes place	Revised SMAE value determined by	Reflected in value of MOD for Regulatory Year
2015/16	30 Nov 2016	2017/18
2016/17	30 Nov 2017	2018/19
2017/18	30 Nov 2018	2019/20
		Et seq

8.9 The last Regulatory Year t-2 for which a revised SMAE value will be determined during the Price Control period is 2020/21. This is because smart meter installation numbers for the last two regulatory Years of the Price Control Period (2020/21 and 2021/22) will not be available in time to be included in a value for the term MOD. Adjustments to allowed Totex expenditure on Smart meter roll-out activity during 2020/21 and 2021/22 will be taken into account in the setting of the RIIO-ED2 price control arrangements for the licensee.

8.10 Notwithstanding the routine timings set out in Table 8.1, the Authority may, in respect of any Annual Iteration Process, determine that the SMAE value for a

Regulatory Year earlier than Regulatory Year t-2 should be revised, if that is necessary because the licensee has been required to restate any numbers relating to Smart Meter Roll-out under any provision of the licence. In those circumstances the revision to the SMAE value concerned would again be determined using the formula contained in CRC 3E, but using the restated values for the Regulatory Year in question.

Notification and direction of revised PCFM Variable Values

8.11 Paragraph 3E.14 of CRC 3E requires the Authority to give the licensee at least 14 days' notice setting out any revisions to SMAE values that it has determined, before directing the revisions. This means that, subject to paragraph 8.8, the Authority will give notice to the licensee of any SMAE value revisions that it has determined by 15 November in each Regulatory Year t-1. The Authority is required to have due regard to any representations made by the licensee and to give its reasons for any decisions in relation to them.

8.12 Having complied with the notice requirements referred to in paragraph 8.11, the Authority will direct a revised SMAE value for Regulatory Year t-2 (and for any earlier Regulatory Years for which Smart Meter Roll-out numbers have been restated) by 30 November in each Regulatory Year t-1.

Delay in direction of revised PCFM Variable Values

8.13 If, for any reason, the Authority does not give a required direction of an SMAE value or values by 30 November in any Regulatory Year t-1, CRC 3E requires that the value or values should be directed by the Authority as soon as is reasonably practicable, to facilitate the notification and direction of the value of the term MODt under Charge Restriction Condition 4B (Annual Iteration Process for the PCFM).

9. Load Related Expenditure - financial adjustment methodology

Part 1 – Overview

9.1 The licence includes a mechanism ('the load related reopener') to adjust the licensee's allowed level of Load Related Expenditure to address uncertainty over the investment required during the Price Control Period to accommodate new and changing patterns of electricity use by electricity consumers.

9.2 Charge Restriction Condition CRC 3G (Revising the allowed level of Load Related Expenditure) sets out the categories of expenditure that are included in the load related reopener, the application windows during which the licensee can propose 'relevant adjustments', and the criteria for the proposal of a relevant adjustment. It also sets out how the Authority will determine any revisions to the licensee's allowed level of Load Related Expenditure.

9.4 The licensee's opening allowed levels of Load-Related Expenditure (in 2012/13 prices) were included in the calculation of its Opening Base Revenue Allowances and:

- set out against the licensee's name in the Table at Appendix 1 to CRC 3G;
- represented by the opening values of the PCFM Variable Value for allowed Load-Related Expenditure for the licensee (LRRC values).

9.5 The Authority's ED1 Strategy Decision document stated that opening allowed levels of Load-Related Expenditure might need to be adjusted in light of additional efficient costs driven by network loading and development requirements (see associated document a.). These adjustments are catered for in CRC 3G and the methodology set out in this chapter. The LRRC value for each Regulatory Year, revised as applicable, represents the licensee's total amount of allowed Load-Related Expenditure (in 2012/13 prices) for that Regulatory Year.

9.6 These provisions mean that revised allowed levels of Load-Related Expenditure (represented by revised LRRC values) can be included in the Annual Iteration Process for the PCFM so that they interact with actual expenditure information and are appropriately reflected in Totex Incentive Mechanism adjustments and the calculation of values for the term MOD for the licensee.

9.7 The effects of revising LRRC values for Regulatory Years earlier than Regulatory Year t flow through to the determination of the value of MOD_t with appropriate Time Value of Money adjustments under the functionality of the PCFM.

Part 2 – Determination of revised allowed levels of Load-Related Expenditure

9.8 Part A of CRC 3G provides for both the Authority and the licensee to propose 'relevant adjustments' to allowed levels of Load-Related Expenditure. A proposed adjustment must:

(i) be based on information about the actual or forecast level of efficient Load-Related Expenditure that was not available when the licensee's Opening Base Revenue Allowances were derived;

(ii) take account of any relevant adjustments previously determined under CRC 3G;

(iii) constitute a material amount based on the two criteria as set out against the licensee's name in the table in Appendix 2 to CRC 3G);

(iv) relate to costs incurred or expected to be incurred after 1 April 2015; and

(v) constitute an adjustment to allowed expenditure which cannot be made under the provisions of any other Charge Restriction Condition.

9.9 Furthermore, any proposal must set out:

(i) the changes to the licensee's allowed levels of Load-Related Expenditure (LRRC values) that are proposed and the Regulatory Years to which those changes relate;

(ii) the change to the licensee's Specific Customer-funded Reinforcement Percentage Bands that are proposed;

(iii) the basis of calculation for the changes to the licensee's allowed level of Load Related Expenditure; and

(iv) appropriate supporting evidence including actual and forecast movements in the load indices.

Application windows

9.10 The licensee may only propose relevant adjustments during the following application windows:

- the first application window which opens on 1 May 2017 and closes on 31 May 2017; and
- the second application window which opens on 1 May 2020 and closes on 31 May 2020.

9.11 Relevant adjustments may be proposed by the licensee during both the first and second application windows provided that each proposal complies with the provisions of paragraphs 3G.7 and 3G.8 in CRC 3G.

9.12 The Authority may give Notice of its intention to make a relevant adjustment after the end of the Price Control Period during the window which opens on 1 September 2023 and closes on 30 September 2023.

Determination of revisions to allowed levels of expenditure

9.13 Paragraph 3G.12 of CRC 3G gives the Authority four months from the close of each application window to determine relevant adjustments to allowed levels of Load-Related Expenditure proposed during the window concerned. A determination under paragraph 3G.12 of CRC 3G may confirm, reject, or amend the proposed relevant adjustment. If allowed expenditure levels are revised, the Authority will also determine the Regulatory Years to which those revisions are to be applied, which may be any of the Regulatory Years in the Price Control Period.

9.14 If the Authority does not make a determination by the end of the four month period referred to in paragraph 9.13, and the proposal was properly made and not withdrawn, then the proposed adjustment to the licensee's allowed levels of Load-Related Expenditure will be deemed to have been made (see paragraph 3G.21 of CRC 3G).

9.15 For the avoidance of doubt, Real Price Effects (RPE) will not be taken into consideration for the purpose of relevant adjustments under CRC 3G.

9.16 Before determining any relevant adjustment, the Authority will:

- consult with the licensee and other interested parties;
- have regard to the basis on which opening levels of allowed Load-Related Expenditure were set for the licensee;
- take no account of the general financial performance of the licensee under the price control arrangements set out in the Charge Restriction Conditions of the licence;
- consider any off-setting demand-side response or use of other non-traditional reinforcement solutions that have avoided general reinforcement expenditure; and
- consider whether the licensee's relevant expenditure has fallen outside any Specific Customer-funded Reinforcement Percentage Band under CRC 5G

9.17 In determining any revision to LRRC Values, the Authority will make no adjustment to allowed Load Related Expenditure in respect of changes to costs within the licensee's upper threshold and lower threshold as detailed in Appendix 2 of CRC 3G. Any changes to forecasts within the licensee's upper threshold and lower threshold will be subject to the Totex Incentive Mechanism (see chapter 6)

9.18 Any determination of a relevant adjustment will specify:

(a) the Regulatory Years to which any determined changes to allowed levels of Load related Expenditure apply; and

(b) the revised total allowed levels of Load-Related Expenditure for the licensee (in 2012/13 prices) for each of the Regulatory Years specified under sub-paragraph (a).

9.19 Paragraph 3G.20 of CRC 3G requires the Authority to notify the licensee of any determination within 14 days of making it.

Part 3 - Determination, notification and direction of revised PCFM Variable Values for Load-Related Expenditure (LRRC values)

Timing of determination and direction of revised LRRC values

9.20 After, 31 October following the closure of each of the application windows referred to in paragraph 9.10, a check will be made to see whether any determination has been made under the provisions of Part A of CRC 3G, and Part 2 of this chapter, that has not previously been taken into account in a determination of revisions to LRRC Values for the licensee.

9.21 If any determination has not previously been taken into account, the Authority will, by 30 November in the same year, determine that the LRRC values for the Regulatory Years concerned should be revised so that they equate to the new allowed levels of Load-Related Expenditure specified in the determination referred to in part 2.

9.22 Indicative timings for the determination and direction of revised LRRC values are summarised in Table 9.1 below.

Table 9.1 – Indicative timings for the revision of LRRC values

Application window	Revised levels of allowed expenditure determined by	Revised LRRC values determined and directed by	Reflected in value of MOD for Regulatory Year
May 2017	30 Sep 2017	30 Nov 2017	2018/19
May 2020	30 Sep 2020	30 Nov 2020	2021/22

Notice and direction requirements

9.23 Paragraph 3G.25 of CRC 3G requires the Authority to give the licensee at least 14 days' notice setting out any revisions to LRRC values that it has determined, before directing the revisions. This means that the Authority will give notice to the licensee of any LRRC value revisions that it has determined by 15 November in the Regulatory Year t-1 concerned (see temporal convention in chapter 1). The Authority is required to have due regard to any representations made by the licensee and to give its reasons for any decisions in relation to them.

9.24 Having complied with the notice requirements, the Authority will direct revised LRRC value(s) for the Regulatory Years specified in its determination (or in respect of deemed adjustments – see paragraph 9.14) by 30 November in the Regulatory Year t-1 concerned.

9.25 The consolidated direction of PCFM Variable Value revisions given by the Authority in each Regulatory Year t-1 will include a copy of the PCFM Variable Values Table for the licensee showing the state of all PCFM Variable Values. This will confirm the state of LRRC values in years where no determinations apply to them.

Delay in direction of revised PCFM Variable Values

9.26 If, for any reason, the Authority does not give a required direction of an LRRC value or values by 30 November in 2017 or 2020, CRC 3G requires that the value or values should be directed by the Authority as soon as is reasonably practicable, to facilitate the notification and direction of the value of the term MODt under Charge Restriction Condition 4B (Annual Iteration Process for the PCFM).

10. Visual Amenity Projects - financial adjustment methodology

Part 1 – Overview

10.1 Under the RIIO-ED1 price control arrangements the licensee has been given an allowance of allowed expenditure for Visual Amenity Projects. Charge Restriction Condition 3J (Allowed expenditure on Visual Amenity Projects) ('CRC 3J') specifies:

- the licensee's total visual amenity allowed expenditure (TVAA) for the Price Control Period; and
- the basis for determining the licensee's allowed expenditure on Visual Amenity Projects (VAA values) for particular Regulatory Years.

10.2 A qualifying Visual Amenity Project is a scheme for placing existing overhead electricity distribution assets underground so as to improve the visual amenity of a National Park, Area of Outstanding Natural Beauty or National Scenic Area (the 'designated areas'). The RIGs provides further details regarding reporting and definitions relating to this scheme and 'designated areas'.

10.3 CRC 3J provides for the determination of the licensee's allowed expenditure levels on Visual Amenity Projects using a formula for deriving revised values for the PCFM Variable Value "VAA". At the outset of the Price Control Period on 1 April 2015, the VAA value for the licensee for each Regulatory Year of the Price Control Period is set at zero. VAA values are then subject to revision in accordance with the formula set out in paragraph 3J.5 of CRC 3J which is reproduced below:

$$\mathbf{VAA_{t-2} = min\left(VAE_{t-2}, TVAA - \sum_{2015/16}^{t-3} VAA_t\right)}$$

where:

TVAA	means the licensee's total visual amenity allowed expenditure for the Price Control Period, and is set against the licensee's name in Appendix 1, expressed in 2012/13 prices.
VAE_{t-2}	means the amount spent by the licensee in Regulatory Year t-2 on Visual Amenity Projects expressed in 2012/13 prices.

Paragraphs 3J.7 and 3J.8 of CRC 3J respectively specify that:

- for the purposes of the first determination of a revised VAA value, by 30 November 2016, the value of VAA_{t-2} is equal to the lesser of TVAA and VAE_{t-2}; and
- in the formula set out in paragraph 3J.5 of CRC 3J, values of VAA, for Regulatory Years earlier than Regulatory Year t-2, include any revisions to those values as determined by the Authority in accordance with Part B of CRC 3J.

Processing of VAA values under the Annual Iteration Process

10.4 As set out in chapter 1, the Annual Iteration Process for the ED1 Price Control Financial Model calculates values for the term MOD by recalculating base revenue figures for the licensee using revised PCFM Variable Values, including VAA values.

10.5 Functionality contained in the ED1 price Control Financial Model means that the VAA value (as revised) for each Regulatory Year is treated as both the allowed expenditure amount and the actual expenditure amount on Visual Amenity Projects for the Regulatory Year concerned. This has the effect of making eligible expenditure on Visual Amenity Projects neutral for the purpose of the Totex Incentive Mechanism (see chapter 6).

Part 2 - Determination, notification and direction of revised PCFM Variable Values for Visual Amenity Projects (VAA values)

Determination of revised VAA values

10.6 The formula for the licensee's allowed expenditure on Visual Amenity Projects (contained in CRC 3J and reproduced in paragraph 10.3 above) provides an updated level of allowed expenditure for each Regulatory Year t-2 (see note on temporal convention in chapter 1).

10.7 The amount spent by the licensee on Visual Amenity Projects in each Regulatory Year will be reported in its annual cost reporting return for the relevant Regulatory Year t-2. The licensee's annual cost reporting return is submitted to Ofgem under the RIGs.

Timing of determinations of revised VAA values

10.8 The first Regulatory Year of the Price Control Period is Regulatory Year 2015/16. The licensee will report its expenditure on Visual Amenity Projects for Regulatory Year 2015/16 to Ofgem by 31 July 2016. Therefore, subject to the notice requirements set out below, the first determination and direction of a revised VAA value for the licensee will take place by 30 November 2016 for the purposes of the Annual Iteration Process that will take place by 30 November 2016. Subsequent determinations will routinely follow a similar pattern as shown in Table 10.1 below.

10.9 It should be noted, that if the licensee has used up all of its TVAA, the application of the formula in CRC 3J (reproduced in paragraph 10.3 above) will mean that VAA values for subsequent regulatory Years will be determined to be zero.

Table 10.1 – Routine timings for determination of revised VAA values

Regulatory Year t-2 during which Visual Amenity Project expenditure takes place	Revised VAA value determined by	Reflected in value of MOD for Regulatory Year
2015/16	30 Nov 2016	2017/18
2016/17	30 Nov 2017	2018/19
2017/18	30 Nov 2018	2019/20
		Et seq

10.11 The last Regulatory Year t-2 for which a revised VAA value will be determined during the Price Control period is 2020/21. This is because expenditure reporting on Visual Amenity Projects for the last two Regulatory Years of the Price Control Period (2020/21 and 2021/22) will not be available in time to be included in a value for the term MOD. Subject to the amount of the licensee's remaining TVAA, adjustments to allowed expenditure on Visual Amenity Projects in 2020/21 and 2021/22 will be completed during RIIO-ED2 in accordance with the provisions used to calculate VAA in CRC 3J and the guidance contained in this handbook in force at 31st March 2023.

10.12 Notwithstanding the routine timings set out in Table 10.1, the Authority may, in respect of any Annual Iteration Process, determine that the VAA value for a Regulatory Year earlier than Regulatory Year t-2 should be revised, if that is necessary because the licensee has been required to restate any values relating to Visual Amenity Projects under any provision of the licence. In those circumstances the revision to the VAA value(s) concerned would again be determined using the formula contained in CRC 3J, but using the restated values for the Regulatory Year(s) in question.

Notification and direction of revised PCFM Variable Values

10.13 Paragraph 3J.13 of CRC 3J requires the Authority to give the licensee at least 14 days' notice setting out any revisions to VAA values that it has determined, before directing the revisions. This means that the Authority will give notice to the licensee of any VAA value revisions that it has determined by no later than 15 November in each Regulatory Year t-1. The Authority is required to have due regard to any representations made by the licensee and to give its reasons for any decisions in relation to them.

10.14 Having complied with the notice requirements referred to in paragraph 10.13, and subject to paragraph 10.11 above, the Authority will direct a revised VAA value for Regulatory Year t-2 (and for any earlier Regulatory Years for which relevant values have been restated) by 30 November in each Regulatory Year t-1.

Delay in direction of revised PCFM Variable Values

10.15 If, for any reason, the Authority does not give a required direction of a VAA value or values by 30 November in any Regulatory Year t-1, CRC 3J requires that the value or values should be directed by the Authority as soon as is reasonably practicable, to facilitate the notification and direction of the value of the term MOD_t under Charge Restriction Condition 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

11. Worst served customers - financial adjustment methodology

Part 1 – Overview

11.1 The associated Charge Restriction Condition for this chapter is CRC 3H (Allowed expenditure on improving services to Worst Served Customers) ('CRC 3H').

11.2 The RIIO-ED1 price control arrangements include a general incentive for the licensee to improve supply interruption performance, contained in CRC 2D (Adjustment of licensee's revenues to reflect interruptions related quality of service performance). However, the licensee has also been given an expenditure allowance for projects to improve services to 'Worst Served Customers'. The definition of a Worst Served Customer is contained in the RIGs, together with the criteria that service improvement projects must meet.

11.3 The licensee's allowed expenditure level on projects to improve services to Worst Served Customers is capped by both:

(i) a total expenditure limit that is specified in Appendix 1 of CRC 3H, in 2012/13 prices; and

(ii) a limit on the maximum amount of expenditure per Worst Served Customer ("Worst Served Customer Cap Per Customer") that is specified in Appendix 2 of CRC 3H .

11.4 The arrangements are neutral with respect to the Totex Incentive Mechanism (see paragraph 11.7 below).

11.5 CRC 3H provides for the determination of the licensee's allowed expenditure levels on projects to improve services to Worst Served Customers using a formula for deriving revised values for the PCFM Variable Value "WSCC". At the outset of the Price Control Period on 1 April 2015, the WSCC value for the licensee for each Regulatory Year of the Price Control Period is set at zero. WSCC values are then subject to revision in accordance with the formula set out in paragraph 3H. 5 of CRC 3H which is reproduced below:

$$\mathrm{WSCC}_{t-2} = \min\left(\mathrm{WSE}_{t-2}, \mathrm{TWSCC} - \sum_{2015/16}^{t-3} \mathrm{WSCC}_{t}\right)$$

where:

TWSCC means the licensee's total amount of allowed expenditure on Worst Served Customer Projects for the Price Control Period, and is set against the licensee's name in Appendix 1 of CRC 3H, expressed in 2012/13 prices.

WSE_{t-2} means, subject to paragraph 3H.9 in CRC 3H, the amount spent by the licensee in Regulatory Year t-2 on Worst Served Customer Projects, expressed in 2012/13 prices.

11.6 In addition, the licensee must ensure that the amount of expenditure on improving services to any one Worst Served Customer included in values for the term WSE that it reports during the Price Control Period does not exceed the Worst Served Customer Cap Per Customer set out for the licensee at Appendix 2 to CRC 3H. Expenditure exceeding this cap is to be excluded by the licensee from reported values for the term WSE.

11. 7 The RIGs will provide further details regarding the definitions and reporting criteria for values of the term WSE and in respect of the Worst Served Customer Cap Per Customer.

Processing of WSCC values under the Annual Iteration Process

11.7 As set out in chapter 1, the Annual Iteration Process for the ED1 Price Control Financial Model calculates values for the term MOD by recalculating base revenue figures for the licensee using revised PCFM Variable Values, including WSCC values.

11.8 Functionality contained in the ED1 price Control Financial Model means that the WSCC value (as revised) for each Regulatory Year is treated as both the allowed expenditure amount and the actual expenditure amount for Worst Served Customer Projects for the Regulatory Year concerned. This has the effect of making eligible expenditure on Visual Amenity Projects neutral for the purpose of the Totex Incentive Mechanism (see chapter 6).

Part 2 - Determination, notification and direction of revised PCFM Variable Values for projects to improve services to Worst Served Customers (WSCC values)

Determination of revised WSCC values

11.9 The formula for the licensee's allowed expenditure on projects to improve services to Worst Served Customers (contained in CRC 3H and reproduced in paragraph 11.5 above) provides an updated level of allowed expenditure for each Regulatory Year t-2 (see note on temporal convention in chapter 1).

11.10 The amount spent by the licensee on projects to improve services to Worst Served Customers in each Regulatory Year will be reported in its annual cost reporting return for the relevant Regulatory Year t-2. The licensee's annual cost reporting return is submitted to Ofgem under the RIGs.

Timing of determinations of revised WSCC values

11.11 The first Regulatory Year of the Price Control Period is Regulatory Year 2015/16. The licensee will report its expenditure on projects to improve services to Worst Served Customers for Regulatory Year 2015/16 to Ofgem by 31 July 2016. Therefore, subject to the notice requirements set out below, the first determination and direction of a revised WSCC value for the licensee will take place by 30 November 2016 for the purposes of the Annual Iteration Process that will take place by 30 November 2016. Subsequent determinations will routinely follow a similar pattern as shown in Table 11.1 below.

11.12 It should be noted, that if the licensee has used up all of its total allowance (TWSCC) the application of the formula in CRC 3H (reproduced in paragraph 11.5) will mean that WSCC values for subsequent Regulatory Years will be determined to be zero.

Table 11.1 – Routine timings for determination of revised WSCC values

Regulatory Year t-2 during which project expenditure takes place	Revised WSCC value determined by	Reflected in value of MOD for Regulatory Year
2015/16	30 Nov 2016	2017/18
2016/17	30 Nov 2017	2018/19
2017/18	30 Nov 2018	2019/20
		Et seq

11.13 The last Regulatory Year t-2 for which a revised WSCC value will be determined during the Price Control period is 2020/21. This is because expenditure on projects to improve services to Worst Served Customers for the last two Regulatory Years of the Price Control Period (2020/21 and 2021/22) will not be available in time to be included in a value for the term MOD. Therefore, adjustments to allowed expenditure on Worst Served Customer Projects in 2020/21 and 2021/22 will be taken into account in the RIIO-ED2 price control arrangements for the licensee in a way that is consistent with the provisions for the calculation of WSCC values in the licence and this handbook in the form they are in as at 31 March 2023. For the avoidance of doubt this includes the provisions relating to the licensee's total amount of allowed expenditure on Worst Served Customer Projects for the Price Control Period and the Worst Served Customer Cap Per Customer.

11.14 Notwithstanding the routine timings set out in Table 11.1, the Authority may, in respect of any Annual Iteration Process, determine that the WSCC value for a Regulatory Year earlier than Regulatory Year t-2 should be revised, if that is necessary because the licensee has been required to restate any values relating to projects to improve services to Worst Served Customers under any provision of the licence. In those circumstances the revision to the WSCC value(s) concerned would again be determined using the formula contained in CRC 3H, but using the restated values for the Regulatory Year(s) in question.

Notification and direction of revised PCFM Variable Values

11.15 Paragraph 3H.14 of CRC 3H requires the Authority to give the licensee at least 14 days' notice setting out any revisions to WSCC values that it has determined, before directing the revisions. This means that the Authority will give notice to the licensee of any WSCC value revisions that it has determined by 15 November in each Regulatory Year t-1. The Authority is required to have due regard to any representations made by the licensee and to give its reasons for any decisions in relation to them.

11.16 Having complied with the notice requirements referred to in paragraph 11.15, and subject to paragraphs 11.13 and 11.14 above, the Authority will direct a revised WSCC value for Regulatory Year t-2 by 30 November in each Regulatory Year t-1.

Delay in direction of revised PCFM Variable Values

11.17 If, for any reason, the Authority does not give a required direction of a WSCC value or values by 30 November in any Regulatory Year t-1, CRC 3H requires that the value or values should be directed by the Authority as soon as is reasonably practicable, to facilitate the notification and direction of the value of the term MOD_t under Charge Restriction Condition 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

12. Innovation Roll-out Mechanism allowed expenditure – financial adjustment methodology

Part 1 - Overview

12.1 Charge Restriction Condition 3D (The Innovation Roll-out Mechanism) ('CRC 3D') sets out the basis for determining the licensee's allowed expenditure relating to Innovation Roll-out (IRM values) for particular Regulatory Years. All IRM values are stated in 2012/13 prices.

12.2 At the outset of the Price Control Period on 1 April 2015, the IRM value for the licensee for each Regulatory Year of the Price Control Period is set at zero and the licensee's Opening Base Revenue Allowances were modelled on this basis.

12.3 CRC 3D sets out the basis on which allowed expenditure on the roll-out of proven innovations can be revised through Relevant Adjustments. It also sets out how IRM values can be revised.

12.4 Under the Annual Iteration Process, allowed expenditure levels on Innovation Roll-out, represented by IRM values, as revised, interact with actual expenditure information so that appropriate Totex Incentive Mechanism adjustments are reflected in the calculation of values for the term MOD.

12.5 IRM values are stated in 2012/13 prices, consistent with the price base used in the PCFM and the values for the term MOD. The effects of revising IRM values for Regulatory Years earlier than Regulatory Year t flow through to the determination of the value of MOD_t with appropriate Time Value of Money adjustments under the functionality of the PCFM.

12.6 CRC 3D provides for:

- the licensee to propose revisions to levels of allowed expenditure (Relevant Adjustments), but only during each of two application windows specified in CRC 3D (see paragraph 12.7); and
- the determination of Relevant Adjustments by the Authority.

12.7 The application windows during which the licensee can propose Relevant Adjustments run from:

(a) 1 May 2017 to 31 May 2017; and

(b) 1 May 2020 to 31 May 2020.

12.8 Any Relevant Adjustment resulting from a proposal made during the first application window may only provide for the revision of the IRM value for Regulatory Year 2018/19 and later Regulatory Years in the Price Control Period. Any Relevant

Adjustment resulting from a proposal made during the second application window may only provide for the revision of the IRM value for Regulatory Year 2021/22 and regulatory Year 2022/23.

12.9 Paragraph 3D.14 of CRC3D specifies that a Relevant Adjustment proposal notice by the licensee must:

(a) state any statutory obligations or any requirements of the licence to which the notice relates;

(b) describe the Proven Innovation that the licensee proposes to Roll-out;

(c) propose the amount of the Relevant adjustment and set out, by reference to the Innovation Roll-out Costs, the basis on which the licensee has calculated the Relevant Adjustment;

(d) demonstrate that the costs to be recovered through the Relevant Adjustment will be a material amount for the purposes of paragraph 3D.10 of CRC 3D (see paragraph 12.10 below);

(e) demonstrate how each of the criteria set out in Part B of CRC 3D will be fulfilled by the Roll-out using the additional funding sought;

(f) propose relevant outputs or other end products against which the Roll-out will be assessed;

(g) set out the revisions to IRM values that the licensee considers should be made to implement the Relevant Adjustment; and

(h) state the date from which it is proposed that the Relevant Adjustment would have effect ("the adjustment date") and the Regulatory Years to which the Relevant Adjustment would apply.

Materiality threshold

12.10 For the purposes of the requirement at subparagraph 12.9(d) above, the definition of a material amount is set out at paragraph 3D.10 of CRC 3D.

12.11 The Authority may determine Relevant Adjustments to the licensee's levels of allowed expenditure with respect to proposals made by the licensee within four months of the close of the application window concerned. Determinations will be made in accordance with the methodology set out in part 2 of this chapter. Part 4 of this chapter provides for the determination and direction or revised IRM values. The IRM value for any particular Regulatory Year, as revised represents the total amount of allowed Totex expenditure (in 2012/13 prices) for Innovation Roll-out for that Regulatory Year.

Part 2 - Methodology for determining Relevant Adjustments in respect of Innovation Roll-out

12.12 If the Authority receives notice of a proposed Relevant Adjustment from the licensee in respect of Innovation Roll-out costs it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

Determination steps

(i) The Authority will check whether the notice has been received during one of the two application windows referred to in paragraph 12.7. If the notice has been received before the start of an application window the Authority will notify the licensee that the notice has been submitted too early and should be resubmitted during an application window. If the notice has been received after 31 May 2020 the Authority will notify the licensee that the notice has been received too late and that a Relevant Adjustment will not be determined.

(ii) The Authority will check whether each of the requirements set out in paragraph 3D.14 of CRC 3D has been met;

(iii) The Authority will decide whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required it will call for that information from the licensee, setting a deadline for submission that takes account of:

- a. the amount of time that the licensee will reasonably require to compile the information;
- b. the four month period for determinations referred to in paragraph 3D.16 of CRC 3D; and
- c. the need to consult the licensee on its proposed determination.

(iv) The Authority will consider the factors set out in paragraph 3D.8 of CRC 3D, namely whether the innovation/proposed relevant adjustment:

- a. will deliver Carbon Benefits or any wider environmental benefits;
- b. will provide long-term value for money for electricity consumers;
- c. will not enable the licensee to receive commercial benefits from the Roll-out within the remainder of the Price Control Period (for instance, where the Roll-out of a Proven Innovation will lead to cost savings (including benefits from other incentive mechanisms) equal to or greater than its implementation costs within the Price Control Period); and
- d. will only be used to fund the Roll-out of a Proven Innovation.

(v) Having carried out steps (i) to (iv) above, the Authority will provisionally determine whether to:

a. reject the Relevant Adjustment proposed by the licensee;

b. confirm the Relevant Adjustment proposed by the licensee; or

c. amend the Relevant Adjustment proposed by the licensee.

If the Authority considers that the licensee's proposal should be confirmed or amended it will provisionally determine the adjustments to allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied.

(vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.

(vii) The Authority will consider any consultation responses from the licensee and will then make a Relevant Adjustment determination.

12.13 A determination by the Authority that confirms or amends a Relevant Adjustment proposed by the licensee in respect of Innovation Roll-out will specify:

(a) the Regulatory Years to which the determination applies; and

(b) revised amounts of allowed expenditure (in 2012/13 prices) for the Innovation Roll-out for each of the specified years.

12.14 The Authority will apply any Relevant Adjustment determined under this part in the determination of revised IRM values under part 3 of this chapter.

Part 3 – Determination, notification and direction of revised IRM values

12.15 CRC 3D specifies that IRM values for the licensee as at 1 April 2015 for each Regulatory Year of the Price Control Period will be zero.

12.16 On or before 31 October in Regulatory Years 2017 and 2020, Ofgem will check to see whether any determinations of Relevant Adjustments have been made in respect of Innovation Role-out that change levels of allowed expenditure for the licensee and that have not previously been taken fully into account in the determination of revisions to IRM values for the Regulatory Year or Years concerned.

12.17 If determinations of Relevant Adjustments have not previously been taken into account, the Authority will determine that the IRM value for the Regulatory Year or Years concerned is to be revised so that it takes into account the revised allowed expenditure amounts (in 2012/13 prices) specified in the Relevant Adjustment determinations.

Notification and direction of revised IRM values

12.18 The Authority will give notice of any revisions to IRM values that it proposes to direct by 15 November in Regulatory Years 2017 and 2020, being at least 14 days before the deadline date of 30 November in each of those years for the direction of revised PCFM Variable Values. The notice will confirm that:

- any revised IRM value determinations have been made in accordance with Part G of CRC 3D; and
- the licensee has 14 days from the date of the notice in which to make any representations concerning proposed IRM value revisions.

12.19 The Authority is required to have due regard to any representations or objections made by the licensee and to give its reasons for any decisions in relation to them.

12.20 The Authority will only direct IRM value revisions in accordance with the provisions of CRC 3D. However, the overall direction of PCFM Variable Value revisions in each Regulatory Year t-1 will include a copy of the PCFM Variable Values Table for the licensee showing the state of all PCFM Variable Values including IRM values.

Delay in direction of revised IRM values

12.21 If the procedures set out in Charge Restriction Condition 3D and this chapter call for the Authority to direct revised IRM values by 30 November 2017 or 30 November 2020, and the Authority does not make such a direction, then CRC 3D requires that the values concerned should be directed by the Authority as soon as is reasonably practicable, to facilitate the notification and direction of the value of the term MOD_t for the licensee under Charge Restriction Condition 4B (Annual Iteration Process for the PCFM).

12A. WPD Rail electrification allowed expenditure – financial adjustment

Part 1 - Overview

12A.1 The associated Charge Restriction Condition for this chapter is CRC 3K (Rail electrification adjustments) ('CRC 3K'). This chapter is only applicable to the following licensees:

- Western Power Distribution (East Midlands) plc;
- Western Power Distribution (West Midlands) plc;
- Western Power Distribution (South Wales) plc; and
- Western Power Distribution (South West) plc.

12A.2 The modelling of the licensee's Opening Base Revenue Allowances included allowed Totex expenditure amounts for asset diversion works (the movement of electrical lines or plant) necessitated by the rail electrification projects set out in Table 12A.1 below which are being undertaken by Network Rail.

Table 12A.1 – Rail electrification projects

Rail electrification project	West Midlands	East Midlands	South Wales	South West
Paddington-Swansea	✓	n/a	✓	✓
Cardiff- Valleys	n/a	n/a	✓	n/a
Midlands Mainline	n/a	✓	n/a	n/a
Birmingham-Plymouth	✓	n/a	n/a	✓

12A.3 The allowed Totex expenditure amounts referred to in paragraph 12A.2 were based on the expected level of diversion costs payable by the licensee during the Price Control Period ('expected diversion costs') in respect of the projects set out in Table 12A.1, as applicable to the licensee. These amounts were based on assumptions included in the licensee's business plan for the RIIO-ED1 price control.

12A.4 If the Authority is notified that, or becomes aware that, some of the expected diversion costs will be met by another party (through ' additional contributions') it may determine that the licensee's allowed Totex expenditure should be reduced by an equivalent amount. The reduction is applied to the ANLR category of Totex (see Table 6.2 in chapter 6).

12A.5 CRC 3K provides for the Authority to direct changes to the PCFM Variable Values that relate to reductions in allowed Totex expenditure associated with additional contributions (RE values). Proposed changes must be made in accordance with the methodology set out in this chapter.

12A.6 The RE values for each Regulatory Year have opening values (at 1 April 2015) of zero, because they represent the reduction in allowed Totex expenditure that has been applied. The following points apply to RE values:

(i) RE values can only be zero or negative.

(ii) The RE value for any Regulatory Year in the Price Control Period can be revised at any time before 30 November 2021 where that is consistent with the methodology set out in part 2 of this chapter.

12A.7 Any revised RE values are processed under the Annual Iteration Process as changes to allowed expenditure (see paragraph 2.5 and Table 2.1 in chapter 2) with the effects flowing through to the calculation and determination of the value of the term MOD for Regulatory Year t.

12A.8 It should be noted that there is no provision to revise allowed levels of Totex expenditure for the licensee (upwards or downwards) in respect of outturn levels of diversion work activity – only in respect of the level of additional contributions.

Part 2 – Determination, notification and direction of revised PCFM Variable Values for rail electrification (RE values)

Determination of revised RE values

12A.9 The Authority will take no action with respect to the revision of RE values unless it is notified that, or becomes aware that, some expected diversion costs will be met by additional contributions.

12A.10 Subject to paragraph 12A.12, if the Authority it is notified that, or becomes aware that, some expected diversion costs will be met by additional contributions it will review the information and confer with the licensee to verify the actual level of additional contributions that apply to each Regulatory Year in the Price Control Period. Having done this, the Authority will determine that the RE value for each Regulatory Year should be revised to a value ascertained using the following formula:

Revised RE value = (-1 x aggregate amount of additional contributions)

12A.11 In the formula for revised RE values set out in paragraph 12A.10, the reference to the 'aggregate amount of additional contributions' means the sum (expressed in 2012/13 prices) of:

(i) any additional contributions for the Regulatory Year concerned that have been taken into account in a prior revision of the RE value ; and

(ii) any incremental additional contributions for the Regulatory Year concerned of which the Authority has been notified or become aware.

The aggregate amount of additional contributions is multiplied by negative 1, so that it is treated by the PCFM as a reduction in allowed Totex expenditure.

12A.12 Paragraph 3K.6 of CRC 3K specifies that the last date by which the Authority can direct that RE values for the licensee are to be revised is 30 November 2021, for the purpose of the Annual Iteration Process that will take place by 30 November 2021 (the last Annual Iteration Process during the Price Control Period.) It is expected that all necessary revisions to RE values will be directed by this point. However, for the avoidance of doubt, if the Authority is notified of, or becomes aware of, additional contributions too late to include in a revision of RE values, then those additional contributions will be addressed under the RIIO-ED2 price control arrangements.

12A.13 For the purpose of determining any revisions to RE values, additional contributions will be applied to the Regulatory Year in which the associated costs are reported. There is no materiality threshold with respect to the level of additional contributions that can be taken into account.

12A.14 The licensee is required to report all diversion costs and contributions in accordance with applicable requirements contained in the RIGs[28].

Notification and direction of revised RE values

12A.15 References to Regulatory Year t-1 in this section follow the convention set out in paragraph 1.7 of this handbook - ie each should be read as being relative to a Regulatory Year t in which the MOD term is used to adjust the licensee's Opening Base Revenue Allowance.

12A.16 Subject to paragraph 12A.12, if, by 31 October in any Regulatory Year t-1, the Authority determines that one or more RE values should be revised it will give notice to the licensee of the proposed revisions by 15 November in the same Regulatory Year t-1 (being at least 14 days before the deadline date for the direction of revised PCFM Variable Values). The notice will confirm that:

- any revised RE values have been determined in accordance with Part A of CRC 3K, which cross refers to this chapter of the ED1 Price Control Financial Handbook; and

[28] See Glossary

- the licensee has 14 days from the date of the notice in which to make any representations concerning the proposed RE value revisions.

12A.17 The Authority is required to have due regard to any representations or objections made by the licensee and to give its reasons for any decisions in relation to them.

12A.18 Subject to paragraph 12A.12, if the Authority determines that one or more RE values should be revised after 31 October in any Regulatory Year t-1, then the Authority will give notice to the licensee of the proposed revisions by 15 November in the next Regulatory Year.

Delay in direction of revised RE values

12A.19 If the methodology set out in this part calls for the Authority to direct revised RE values by 30 November in a particular Regulatory Year t-1, and the Authority does not make such a direction, then paragraph 3K.10 of CRC 3K requires that the values should be directed by the Authority as soon as is reasonably practicable, to facilitate the notification and direction of the value of the term MOD_t under Charge Restriction Condition 4B (Annual Iteration Process for the PCFM).

Section 2

Legacy price control adjustment methodologies

[not included in this consultation]

Appendix 1 - Glossary

A

Annual Iteration Process

The Annual Iteration Process is the process set out in Charge Restriction Condition 4B that uses revised PCFM Variable Values in the ED1 Price Control Financial Model to recalculate base revenue figures for the licensee for the Price Control Period. The product of each Annual Iteration Process is the value for the term MOD_t which is a component term in the formula for the licensee's Base Demand Revenue, representing the incremental change to the licensee's Opening Base Revenue Allowance for the Regulatory Year t. The Annual Iteration Process is completed by 30 November in each Regulatory Year t-1 during the Price Control Period.

C

Contingent asset

In the context of the licensee's Pension Scheme Established Deficit, means an asset made subject to arrangements under which it might:

(a) be claimed by the pension scheme trustees;

(b) be reclaimed by the licensee; or

(c) remain subject to the arrangement,

depending on the circumstances arising/prevailing and the contractual terms of the arrangement.

An example of a contingent asset arrangement could be the payment of funds into an escrow account.

Cut-Off Date

In respect of the Pension Scheme Established Deficit for electricity distribution licensees, means 31 March 2010.

D

Defined Benefit Scheme

A pension scheme where the benefits that accrue to members are normally based on a set formula taking into account the final salary and accrual of service in the scheme. It is also known as a final salary pension scheme.

Defined Contribution Scheme

A pension scheme where the benefits that accrue to members are based on the level of cash contributions made to an individual account; the returns on those funds are used to provide a cash amount to purchase an annuity on retirement.

DPCR5 revenue allowance

In this Handbook means the PU value sets against the licensee's name in Appendix 1 to Special condition CRC3 (Restriction of Distribution Charges: Use of System Charges) of the licence in the form which it was in on 31 March 2015 for a particular regulatory year in the DPCR5 price control period.

DPCR5 Time Value of Money Adjustment

A multiplier determined as $(1+X)^{Y}$ where:

- X is the WACC for the licensee applicable in the DPCR5 period which is 4.69%; and
- Y represents the number of years over which the DPCR5 Time Value of Money Adjustment is to be applied

E

Early Retirement Deficiency Contributions (ERDCs)

The cost of providing enhanced pension benefits granted under severance arrangements prior to 1 April 2004 which were not fully matched by increased contributions.

ED1 Price Control Financial Model (ED1 PCFM)

The ED1 Price Control Financial Model that comprises a workbook in Microsoft Excel® format, whose name at any particular time includes the suffix 'November 20XX' (where 20XX represents the calendar year containing the month of November in Regulatory Year t-1). A copy of the extant ED1 PCFM is maintained on the Ofgem website.

The ED1 PCFM is used to determine values for the term MOD through the Annual Iteration Process.

The provisions for modifying the ED1 PCFM are set out in Charge Restriction Condition 4A.

Established Deficit

See Pension scheme Established Deficit

F

Fast money

The proportion of Totex which is not added to the licensee's RAV balance and is effectively included in the licensee's revenue allowance for the year of expenditure (see also Slow Money and Totex Incentive Mechanism).

Funding Adjustment Rate

The percentage calculated as (1 - Totex Incentive Strength Rate).

I

Incentive Strength

See Totex Incentive Strength Rate

Incremental deficit

See Pension scheme incremental deficit.

International Financial Reporting Standards (IFRS)

Accounting standards set by the International Accounting Standards board that ensure the accuracy and comparability of company accounts.

M

MOD

The term of that name included in the formula for Base Demand Revenue set out in Charge Restriction Condition 2A. It represents the incremental change to be applied to the licensee's Opening Base Revenue Allowance for the Regulatory Year concerned. Values for the MOD term are calculated under the Annual Iteration Process for the ED1 Price Control Financial Model - see Charge Restriction Condition 4B and chapter 2 of this handbook.

The value of MOD_t is specified in a direction given by the Authority by 30 November in each Regulatory Year t-1.

N

NPV

Net present value

O

Ofgem

The Office of the Gas and Electricity Markets Authority.

Ongoing pension service costs

All pension costs incurred by the licensee except those relating to the Pension Scheme Established Deficit.

P

PCFM

The RIIO-ED1 Price Control Financial Model (see ED1 PCFM)

Pension Principles

The principles set out in Appendix 7 of the Strategy decision for the RIIO-ED1 electricity distribution price control (Financial issues) published by Ofgem on 4 March 2013 under reference number 26d/13.

Pension Protection Fund (PPF)

The fund, established under the provisions of the Pensions Act 2004, to provide compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer, and where there are insufficient assets in the pension scheme to cover the Pension Protection Fund level of compensation.

Pension Protection Fund (PPF) Levy

The levy on pension schemes by which the PPF is financed. This levy has a number of constituent elements including a fixed element (based on scheme liabilities) and a risk based element (based on the perceived insolvency risk of each scheme). Additionally there is an administration levy charged to cover the PPF running costs.

Pension RIGs

The Energy Network Operators' Price Control Pension Costs - Regulatory Instructions and Guidance: Triennial Pension Reporting Pack supplement including pension deficit allocation methodology published by Ofgem on 12 April 2013.

Pension Scheme Administration

The range of activities that pension scheme trustees are required by legislation to undertake or commission in running the pension scheme. It includes, without limitation, the keeping of scheme records, scheme management and administration, scheme policy and strategy formulation, the provision of information to scheme members, the calculation and payment of benefits, liaison with tax and regulatory authorities and the preparation of valuations. It does not include the provision of advice to the licensee's manager on the management of the scheme or any deficit position. Administration costs do not include investment management fees; these are considered to be deductions from investment returns.

Pension Scheme Established Deficit

The difference between pension scheme assets and liabilities, as determined under periodic scheme valuations, which is attributable to:

- the regulated business; and
- pensionable service up to the end of the cut-off date, which for electricity distributors is 31 March 2010.

If the Established Deficit figure becomes negative, it is referred to as a surplus relating to pensionable service up to the end of the cut-off date.

Pension scheme incremental deficit

The difference between pension scheme assets and liabilities, as determined under periodic scheme valuations, which is attributable to:

- the regulated business; and
- pensionable service after the cut-off date, which for electricity distributors is 31 March 2010.

If the incremental deficit figure becomes negative, it is referred to as a surplus relating to pensionable service after the cut-off date.

R

RAV – Regulatory Asset Value

A financial balance representing expenditure by the licensee which has been capitalised under regulatory rules. The licensee receives a return and depreciation on its RAV in its price control allowed revenues.

Regulatory instructions and guidance (RIGs)

The collective term for documents issued to licensee by the Authority that include:

- instructions regarding data and information that the licensee must report to Ofgem;
- guidance on the way in which data and information should be reported and the timing requirements for submissions; and
- templates, including workbooks in Microsoft Excel® format, for use by the licensee in making submissions.

Regulatory Year

A year beginning on 1 April and ending on 31 March in respect of which price control allowances are set. The RIIO-ED1 Price Control Period comprises the eight Regulatory Years from 1 April 2015 to 31 March 2023.

RIGs

See Regulatory instructions and guidance.

RIIO

Revenue = Incentives + Innovation + Outputs.
Ofgem's framework for the economic regulation of energy networks.

RIIO-ED1 (electricity distribution)

The price control arrangements which will apply to electricity distribution licensees from 1 April 2015 until 31 March 2023

S

Scheme datasets

Pension scheme valuation datasets to be provided to Ofgem in accordance with the Pension RIGs

Slow money

The proportion of Totex which is added to the licensee's RAV balance on which the licensee receives a revenue allowance to cover finance (vanilla WACC) and depreciation costs.

T

Time Value of Money Adjustment

A multiplier used when the award or application of a financial value, attributable to a particular year, is deferred until a later year, even where the deferral is routine and in accordance with a price control mechanism.

In basic terms, for any one year, the multiplier is (1+X) where:

- X is the WACC for the licensee applicable to the period of deferral.

See also DPCR5 Time Value of Money Adjustment

Totex Incentive Mechanism (TIM)

TIM is the mechanism under which adjustments are made to reflect differences between the licensee's allowed Totex and actual. The licensee's Opening Base

Revenue Allowances have been modelled on the basis that actual Totex expenditure levels are expected to equal allowed Totex expenditure levels (allowances). If actual (outturn) expenditure differs from allowances, for any Regulatory Year during the Price Control Period, the TIM provides for an appropriate sharing of the incremental amount (whether an overspend or under spend) between consumers and the licensee in accordance with the licensee's Totex Incentive Strength Rate.

Totex

The term used to describe the licensee's total expenditure (with limited exceptions) on regulated business activities. It includes both capital and operating expenditure items. The Totex approach facilitates the equalisation of incentives (between capital and operating expenditure solutions) under the Totex Incentive Mechanism.

Totex Capitalisation Rate

The percentage of Totex which is added to RAV (see also "slow money").

Totex Incentive Strength Rate

A percentage figure specified in Charge Restriction Condition 3B (Determination of PCFM Variable Values for Totex Incentive Mechanism Adjustments) for the licensee. It represents the percentage of any overspend/under spend against Totex allowances that a licensee bears/retains.

Triennial (pension scheme) valuation

An actuarial valuation of a pension scheme which has been carried out to meet the requirements of Section 224(2)(a) of the Pensions Act 2004 and which results in a written report on scheme assets and liabilities by the scheme actuary. Interim updates to triennial valuations may also be produced.

U

Updated (pension scheme) valuation

A report by the scheme actuary which provides an update on scheme assets and liabilities between triennial valuations.

V

Vanilla WACC

See WACC

W

WACC

The Vanilla Weighted Average Cost of Capital is Ofgem's preferred way of expressing the rate of return allowed on the Regulatory Asset Values (RAV) of price controlled network companies. The use of Vanilla WACC means that the company's tax cost is separately calculated as a discrete allowance so that only the following have to be factored in:

- the pre-tax cost of debt - ie the percentage charge levied by lenders; and
- the post tax cost of equity – ie the percentage return equity investors expect to actually receive,

  weighted according to the price control gearing assumption.

"Real Vanilla WACC" is used which gives a lower percentage than "Nominal Vanilla WACC" would (when inflation is positive). This is because inflation isn't taken into account in the determination of the Real Vanilla WACC percentage.

Worst Served Customer

A customer experiencing five or more higher voltage interruptions on average over a three year period (i.e. 15 or more over three years) with at least three higher voltage interruptions in each year of that three year period.