

# ED1 Price Control Financial Handbook

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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 that is a Distribution Services Provider.

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 the revision of 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

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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 aim of the RIIO approach is to incentivise 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 period is longer than the previous electricity distribution price control (the DPCR5 Price Control), running for eight years instead of five. This provides for a longer period of price control arrangements with the aim of facilitating improved strategic planning and a long-term approach to electricity distribution infrastructure management.

Under the 'DPCR' price controls, base revenue allowances were set up-front for the whole of the price control period, changing only with RPI indexation, requiring certain adjustments to reflect activity levels and varying financial conditions to be left until the subsequent five-yearly review. Under RIIO-ED1, these adjustments to base revenue, along with RPI indexation, will be made each year in respect of the licensee's network business.

This new 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 (Governance of ED1 Price Control Financial Instruments), sets out the methodologies for the revision of PCFM Variable Values. Up-to-date copies of both the handbook and the ED1 Price Control Financial Model will be maintained on the Ofgem Website.

## Associated documents

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a. [Strategy decision for the RIIO-ED1 electricity distribution price control](#)

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

b. [Strategy decision for RIIO-ED1 - Financial issues](#)

<https://www.ofgem.gov.uk/ofgem-publications/47071/riioed1decfinancialissues.pdf>

c. [ED1 PCFM](#)

[www.ofgem.gov.uk](http://www.ofgem.gov.uk) – search term "ED1 PCFM"

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## Introduction

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The ED1 Price Control Financial Handbook ('this handbook') is one of the Price Control Financial Instruments referred to in Charge Restriction Condition 4A (Governance of ED1 Price Control Financial Instruments) of the electricity distribution licence held by Electricity Distribution Network Operators. The Price Control Financial Instruments were included in the licence as a result of the same licence modification that included Charge Restriction Condition 4A in the licence.

This handbook describes the ED1 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 ED1 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.

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 Annual Iteration Process for the PCFM:

- incorporates 'real time' adjustments to financial allowances;
- uses a financial model for the purpose of computing interactions between financial adjustments rather than setting out the relevant algebra on the face of Charge Restriction Conditions;
- provides for consistent treatment of the Totex aspects of the price control;
- provides transparency on adjustments to base revenues, since the licence, methodologies, PCFM and variable values will be published; and
- allows stakeholders to have visibility of base revenue<sup>1</sup> levels to facilitate business sensitivity analysis.

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

- (i) the text of the relevant licence condition(s),
- (ii) this handbook and its constituent methodologies, and
- (iii) the PCFM.

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<sup>1</sup> 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 include additional components specified in CRC 2A (Restriction of Allowed Distribution Network Revenue).



## 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 Gas and Electricity Markets (“Ofgem”) is the office that supports the Authority.

### *Other terminology*

Throughout this handbook:

- (a) ‘licence’ means the relevant electricity distribution licence granted under section 6(1)(c) of the Electricity Act 1989 of which this handbook forms part;
- (b) ‘licensee’ has the meaning given to that term in the licence of which this handbook forms part;
- (c) ‘Charge Restriction Condition’ (abbreviated to ‘CRC’) 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 CRC 4A;
- (e) PCFM means the ED1 Price Control Financial Model which forms part of CRC 4A; and
- (f) ‘Price Control Period’ means the RIIO-ED1 price control period which runs from 1 April 2015 to 31 March 2023.

Other terms used in the text of this handbook that are capitalised are defined in the Glossary, where applicable by reference to the licence or a decision document published by the Authority. Where the meanings of other terms used in this handbook is not clear from the context, they will be explained in the chapter concerned or in the Glossary.



# Part 1

## Introductory chapters

# 1. The ED1 Price Control Financial Model and the Annual Iteration Process

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## Section 1 - Overview

1.1 CRC 2A (Restriction of Allowed Distribution Network Revenue) specifies the Opening Base Revenue Allowance 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 licensee's Opening Base Revenue Allowances are set down against its name in Appendix 1 of CRC 2A and are included in the formula for Base Demand Revenue set out in that condition. Base Demand Revenue is the largest component of the licensee's overall allowed revenue but the other components, specified in the licence, must also be taken into account when assessing total revenue allowances.

1.3 The ED1 Price Control Financial Model (PCFM) calculates 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 referred to 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) and the Totex Incentive Mechanism (see chapter 6); and
- legacy price control adjustments – the close-out of schemes and mechanisms from preceding price control periods.

1.4 The calculations take place under the Annual Iteration Process for the PCFM which is specified in Part A of CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model) and described below. The calculations result in a PCFM output value for the term MOD which is then applied as shown in the simplified<sup>2</sup> formula below:

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

### Price base

1.5 The PCFM works in a constant 2012/13 price base, except in respect of some tax calculations (see paragraph 1.6). 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 CRC 2A.

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<sup>2</sup> The full formula is shown in paragraph 2A.5 of CRC 2A (Restriction of Allowed Distribution Network Revenue).

1.6 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 is aimed at enabling revenue allowance calculations more accurately to reflect the profile of tax expenses of the licensee.

1.7 [Subject to paragraph 1.8,](#) where a methodology in this handbook calls for:

- (a) 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; or
- (b) values in prices of a Regulatory Year other than 2012/13 to be stated in or restated in 2012/13 prices,

the following formula will be used:

$$value_{2012/13\ prices} = value_{nominal/other\ year\ prices} \times \frac{RPI_{2012/13}}{RPI_{nominal/other\ year}}$$

where:

*value*<sub>2012/13 prices</sub>

means the deflated/restated value in 2012/13 prices;

*value*<sub>nominal/other year prices</sub>

means the value in a nominal price base or in prices of a Regulatory Year other than 2012/13;

*RPI*<sub>2012/13</sub>

means the arithmetic average of the Retail Prices Index (all items) published by the Office for National Statistics for each calendar month in Regulatory Year 2012/13 rounded to three decimal places; and

*RPI*<sub>nominal/other year</sub>

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 to which the nominal price base or prices of a Regulatory Year other than 2012/13 relate rounded to three decimal places.

1.8 Some provisions in this handbook provide for RAV balance figures to be inflated by a March/April RPI Factor – see Glossary.

## Temporal convention

1.9 The following conventions apply throughout this handbook.

### *Relative references*

1.10 The MOD term is used to modify the licensee's Opening Base Revenue Allowance for each Regulatory Year  $t$  during the Price Control Period<sup>3</sup>. 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*

1.11 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<sup>4</sup>.

## Section 2 - The PCFM and the Annual Iteration Process

1.12 The PCFM exists as a constituent part of CRC 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.

1.13 At the outset of the Price Control Period, the base revenue figures calculated by the PCFM, using the variable values subsisting at that time, are equal to the Opening Base Revenue Allowances for the licensee.

1.14 Subject to paragraph 1.15, 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 the ED1 Price Control Financial Methodologies set out in chapters 3 to 16 of this handbook.

1.15 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

<sup>3</sup> In 2015-16, the first year of the Price Control Period, the licence specifies that the value of MOD is zero.

<sup>4</sup> EDE values are the PCFM Variable Values for Pension Scheme Established Deficit Expenditure allowances (see Table 2.1 in chapter 2).

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 Regulatory 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.

1.16 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 ED1 Price Control Financial Methodologies.

1.17 In applying the cut-off referred to in paragraph 1.16(b), Ofgem will, through business correspondence, apprise the licensee of any provisionality it has attached to information submissions, that might involve a restatement of the information by the licensee for the purpose of making a further revision to the PCFM Variable Value(s) concerned for use in a subsequent Annual Iteration Process.

1.18 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 PCFM Variable Values after the directed revisions, with revised values highlighted in bold typeface.

1.19 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 columns 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;
- and
- the PCFM will output the value of MOD for Regulatory Year t for the licensee.

1.20 In the context of the Annual Iteration process for the PCFM, the expression 'recalculated base revenue figure' in respect of a particular Regulatory Year means a value calculated in the same way that the licensee's Opening Base Revenue Allowance for that Regulatory Year was calculated, but using revised PCFM Variable Values (see also paragraph 1.13).

- 1.21 The output value of  $MOD_t$  for the licensee will reflect:
- (a) the difference between the recalculated base revenue figure for the licensee for Regulatory Year  $t$  (in the PCFM) and the Opening Base Revenue Allowance set down in the licence; and
  - (b) 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.
- 1.22 The PCFM calculations will apply Time Value of Money Adjustments to the calculation of  $MOD_t$ , to take account of the passage of time between adjustments to Base Demand Revenue in years prior to Regulatory Year  $t$  and the Regulatory Year for which  $MOD_t$  is being calculated.
- 1.23 PCFM Variable Values for Regulatory 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  $t$  represent only a forecast. This is without prejudice to the status of the PCFM Variable Values concerned, which may have been determined or directed under licence conditions and which may or may not be subject to subsequent revision.
- 1.24 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. 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. The steps of the Annual Iteration Process are specified in Part A of CRC 4B.
- 1.25 The Authority will issue a direction to the licensee giving the value of  $MOD_t$  by 30 November in each Regulatory Year  $t-1$ <sup>5</sup> 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 1.18. The value of  $MOD_t$  in the direction will be stated in £m to one decimal place.
- 1.26 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 dates in Regulatory Year  $t-1$  by which the licensee is required to submit its price control information returns (covering activity in Regulatory Year  $t-2$ ) to Ofgem, and

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<sup>5</sup> The first such direction will be given by 30 November 2015.

- the need for the licensee to have confirmation of its Base Demand Revenue in time to calculate and issue its use of system charges.

1.27 Subject to the specification in paragraph 3 of CRC 4B that the last Regulatory Year in which there will be an Annual Iteration Process for the PCFM is Regulatory Year 2021/22, ~~I, i~~ if the Authority does not direct a value for MOD<sub>t</sub> by 30 November in Regulatory Year t-1, paragraphs 4B.12 to 4B.14 of CRC 4B specify that:

- the Annual Iteration Process will not have been completed;
- the Authority will complete the Annual Iteration Process as soon as reasonably practicable after 30 November in the relevant Regulatory Year t-1 by directing a value for MOD<sub>t</sub> for the licensee; and
- in the intervening period, the value of MOD<sub>t</sub> will 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 CRC 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
    - the Regulatory Year equating to Regulatory Year t;
  - pressing the “Run for One” macro button; and
  - recording the value of the term MOD<sub>t</sub> for the licensee that is shown as an output value on the “saved results” sheet.

1.28 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**

<b>Annual Iteration Process (AIP)</b>					
<b>AIP month</b>	<b>PCFM functional change cut-off</b>	<b>Regulatory reporting information cut-off</b>	<b>Notice of proposed PCFM Variable Value revisions by</b>	<b>AIP completed and MOD<sub>t</sub> directed by</b>	<b>Regulatory Year t in which MOD<sub>t</sub> applies</b>
Nov-2015	30 Sep 15	31 Oct 15	15 Nov 15	30 Nov 15	<b>2016/17</b>
Nov-2016	30 Sep 16	31 Oct 16	15 Nov 16	30 Nov 16	<b>2017/18</b>
Nov-2017	30 Sep 17	31 Oct 17	15 Nov 17	30 Nov 17	<b>2018/19</b>
Nov-2018	30 Sep 18	31 Oct 18	15 Nov 18	30 Nov 18	<b>2019/20</b>
Nov-2019	30 Sep 19	31 Oct 19	15 Nov 19	30 Nov 19	<b>2020/21</b>



Nov-2020	30 Sep 20	31 Oct 20	15 Nov 20	30 Nov 20	<b>2021/22</b>
Nov-2021	30 Sep 21	31 Oct 21	15 Nov 21	30 Nov 21	<b>2022/23</b>

*State of the ED1 Price Control Financial Model*

1.29 As stated in paragraph 1.12, the PCFM exists as a constituent part of CRC 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 CRC 4A.

1.30 Ofgem will keep a log of modifications to the PCFM and publish this log on the Ofgem Website.

1.31 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  $t-1$ .

1.32 Ofgem will upload an updated copy of the PCFM to the Ofgem Website by 30 November each year (after each Annual Iteration Process) with the electronic file name "ED1 PCFM November 20XX" in Regulatory Year 20XX/XX (where 20XX/XX is the format used for expressing Regulatory Year  $t-1$ ).

*Error of functionality in the PCFM*

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

- the issue will be considered at the earliest opportunity by the ED1 PCFM Working Group (see next section) and a corrective modification will be proposed by Ofgem;
- if the functional error has 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 in the next calculation of the term  $MOD_t$ ; and
- the procedure in CRC 4A for modifications to the PCFM would be followed.

## Section 3 - The ED1 Price Control Financial Model Working Group

1.34 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.

1.35 In accordance with the provisions of Part A of CRC 4A, 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*

- 1.36 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 CRC 4A; and
  - (iii) to provide such views or recommendations to the Authority with regard to the PCFM (including as to proposals to modify the PCFM) as it sees fit.

#### *Composition*

- 1.37 The composition of the group will be:
- Ofgem (chair);
  - Ofgem (secretary);
  - one representative per licensee; and
  - Energy Networks Association representative (optional).

#### *Timing and duration of the group's work*

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

- 1.39 The group will meet at least once between 1 January and 31 July during each calendar year, but additional meetings may be convened by Ofgem:
- if it considers that such a meeting or meetings would be useful to achieve the purposes of the group; or
  - if such a meeting is requested by at least two licensee's (each from a different ownership group) for the purpose of putting forward a recommendation that a modification should be made to the PCFM.

1.40 In convening any meeting of the working group, Ofgem will give at least 10 working days' notice of the proposed meeting date to the licensee.

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

1.42 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 four licensee representatives (each from a different ownership group) are present.

*Resources*

1.43 Meeting facilities will be provided or coordinated by Ofgem. Ofgem will keep a record of the discussion and views expressed at meetings, and of any recommendations made by the working group with respect to the PCFM. A copy of the record of each meeting will be provided to the licensee and to representatives who attended the meeting, and Ofgem will take account of any comments received in finalising the record.

## 2. The ED1 Price Control Financial Methodologies

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2.1 The ED1 Price Control Financial Methodologies set out in this handbook ('the methodologies') describe the basis for a range of annual adjustments to the licensee's Opening Base Revenue Allowances under the RIIO-ED1 price control arrangements. 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 CRC 4A (Governance of ED1 Price Control Financial Instruments) and are subject to the modification provisions set out in that condition.

2.2 Each methodology sets out the way in which one or more PCFM Variable Values are to be revised as part of the Annual Iteration Process for the ED1 Price Control Financial Model (PCFM) under which values of the term  $MOD_t$  are calculated (see chapter 1). The methodologies do not include details of the calculations carried out by the PCFM which are complex and interdependent. Stakeholders wishing to understand in detail the way in which PCFM Variable Values are processed and values for MOD calculated under the Annual Iteration Process should refer to the PCFM. The PCFM forms part of CRC 4A and is subject to the modification provisions set out in that condition.

2.3 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; 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.

2.4 Each methodology is intended to be consistent with the provisions of any CRC to which it refers or relates. However, in the event of any inconsistency between a methodology and a provision set out on the face of a CRC, the provision in the CRC takes precedence.

### **Methodologies in this handbook**

2.5 The PCFM Variable Values that can be revised under the terms of CRCs and the methodologies in this handbook are set out in Table 2.1 below.

**Table 2.1 - PCFM Variable Values that can be revised under CRCs and the methodologies in this handbook**

PCFM Variable Value	Charge Restriction Condition	Description	Type of variable value	Values at 1 April 2015	Revised values (where directed)	<u>Relevant Licensee</u>
<u>Specified financial adjustments</u>						
EDE (chapter 3)	CRC 3C	Pension Scheme Established Deficit	revenue adjustment	Allowances for Pension Scheme Established Deficit repair used in the calculation of Opening Base Revenue Allowances.	Revised allowances for Pension Scheme Established Deficit repair.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
TTE (chapter 4)		Tax liability – tax trigger events	revenue adjustment	Zero.	Incremental change to tax liability allowances.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
TGIE (chapter 4)		Tax liability – Gearing/interest costs	revenue adjustment	Zero.	Incremental change to tax liability allowances (nominal prices) <sup>6</sup> .	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
CDE (chapter 5)		Allowed percentage cost of corporate debt	percentage	Opening allowed percentage cost of corporate debt.	Revised allowed percentage cost of corporate debt.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
<u>Totex Incentive Mechanism</u>						
ALC (chapter 6)	CRC 3B	Actual load-related capex	actual expenditure	Equal to allowed expenditure level for	Actual load-related capex expenditure	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and</a>

<sup>6</sup> Subject to iterative modelling effect - see paragraph 4.6 in chapter 4.

<b>PCFM Variable Value</b>	<b>Charge Restriction Condition</b>	<b>Description</b>	<b>Type of variable value</b>	<b>Values at 1 April 2015</b>	<b>Revised values (where directed)</b>	<b><u>Relevant Licensee</u></b>
		expenditure		load-related capex.	reported by licensee.	<a href="#"><u>SSES</u></a>
ANLR (chapter 6)		Actual non-load-related capex expenditure - asset replacement	actual expenditure	Equal to allowed expenditure level for non-load-related capex - asset replacement.	Actual non-load-related capex - asset replacement expenditure reported by licensee.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
ANLO (chapter 6)		Actual non-load-related capex - other	actual expenditure	Equal to allowed expenditure level for non-load-related capex - other.	Actual non-load-related capex - other expenditure reported by licensee.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
AFE (chapter 6)		Actual faults expenditure	actual expenditure	Equal to allowed expenditure level for faults.	Actual faults expenditure reported by licensee.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
ARP (chapter 6)		Actual 100% 'revenue pool' expenditure	actual expenditure	Equal to allowed 100% 'revenue pool' expenditure level.	Actual 100% 'revenue pool' expenditure reported by licensee.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
ACO (chapter 6)		Actual controllable opex expenditure	actual expenditure	Equal to allowed expenditure level for controllable opex.	Actual controllable opex expenditure reported by licensee.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
TRE (chapter 6)		Actual tree cutting expenditure	actual expenditure	Equal to allowed expenditure level for tree cutting.	Actual tree cutting expenditure reported by licensee.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>

<b>PCFM Variable Value</b>	<b>Charge Restriction Condition</b>	<b>Description</b>	<b>Type of variable value</b>	<b>Values at 1 April 2015</b>	<b>Revised values (where directed)</b>	<b><u>Relevant Licensee</u></b>
Allowed Totex expenditure adjustments						
UCHVP (chapter 7)	CRC 3F	Uncertain costs – High Value Projects	allowed expenditure	Allowed expenditure level on high value projects used in the calculation of Opening Base Revenue Allowances.	Revised (total) allowed expenditure level on high value projects.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
UCEPS (chapter 7)		Uncertain costs – Enhanced Physical Site Security	allowed expenditure	Allowed expenditure level on enhanced physical site security used in the calculation of Opening Base Revenue Allowances.	Revised (total) allowed expenditure level on enhanced physical site security.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
UCSSW (chapter 7)		Uncertain costs – Specified Street Works	allowed expenditure	Zero.	Total additional allowed expenditure level on specified street works.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
UCRE (chapter 7)		Uncertain costs – Rail Electrification	allowed expenditure	Zero	Revised (total) allowed expenditure level on rail electrification works.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>
UCLB (chapter 7)		Uncertain costs – Link Boxes	allowed expenditure	Zero.	Revised (total) allowed expenditure level on link boxes.	<a href="#">ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</a>

<b>PCFM Variable Value</b>	<b>Charge Restriction Condition</b>	<b>Description</b>	<b>Type of variable value</b>	<b>Values at 1 April 2015</b>	<b>Revised values (where directed)</b>	<b><u>Relevant Licensee</u></b>
						<a href="#"><u>SSES</u></a>
<a href="#"><u>UCSIC</u></a> <a href="#"><u>UCSFE</u></a> (chapter 7)		Uncertain costs – Shetland Uncertain Energy <sup>7</sup>	allowed expenditure	Allowed expenditure level on Shetland Uncertain Energy Costs used in the calculation of Opening Base Revenue Allowances.	Revised (total) allowed expenditure level on Shetland Uncertain Energy Costs.	<a href="#"><u>SSEH</u></a>
UCCPC (chapter 7)		Uncertain costs – Shetland Competitive Process <sup>7</sup>	allowed expenditure	Allowed expenditure level on Shetland Competitive Process used in the calculation of Opening Base Revenue Allowances.	Revised (total) allowed expenditure level on Shetland Competitive Process.	<a href="#"><u>SSEH</u></a>
<a href="#"><u>UCSS-UCSC</u></a> (chapter 7)		Uncertain costs – Subsea Cables <sup>7</sup>	allowed expenditure	Zero.	Revised (total) allowed expenditure level on subsea cables.	<a href="#"><u>SSEH</u></a>
SMAE (chapter 8)	CRC 3E	Smart Meter Roll-out costs	allowed expenditure	Baseline level of allowed expenditure on Smart Meter Roll-out costs used in the calculation of Opening Base Revenue Allowances.	Revised (total) allowed expenditure level on Smart Meter Roll-out costs.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
LRRC (chapter 9)	CRC 3G	Load Related Expenditure	allowed expenditure	Allowed expenditure level on Load Related	Revised (total) allowed level of Load Related	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD,</u></a>

<sup>7</sup> Applicable to Scottish Hydro Electric Power Distribution plc only



<b>PCFM Variable Value</b>	<b>Charge Restriction Condition</b>	<b>Description</b>	<b>Type of variable value</b>	<b>Values at 1 April 2015</b>	<b>Revised values (where directed)</b>	<b><u>Relevant Licensee</u></b>
				Expenditure used in the calculation of Opening Base Revenue Allowances.	Expenditure.	<a href="#"><u>SPMW, SSEH, and SSES</u></a>
VAA (chapter 10)	CRC 3J	Visual Amenity Projects	allowed expenditure	Zero.	Revised (total) allowed expenditure level on Visual Amenity Projects.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
WSCC (chapter 11)	CRC 3H	Worst Served Customer Projects	allowed expenditure	Zero.	Revised (total) allowed expenditure level on Worst Served Customer Projects.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
IRM (chapter 12)	CRC 3D	Innovation Roll-out mechanism	allowed expenditure	Zero.	Revised (total) allowed expenditure level on Innovation Roll-out.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
<del>UNMCUCMC</del> (chapter 12B)	<del>CRC 3L</del>	Moorside <sup>8</sup>	allowed expenditure	<del>Zero.</del>	Revised allowed expenditure level on Moorside	<a href="#"><u>ENWL</u></a>
Legacy price control adjustments						
LTPG	CRC 3A	Legacy	balance	Zero.	Incremental change to	<a href="#"><u>ENWL, NPgN, NPgY,</u></a>

<sup>8</sup> Applicable to Electricity North West Ltd only

<b>PCFM Variable Value</b>	<b>Charge Restriction Condition</b>	<b>Description</b>	<b>Type of variable value</b>	<b>Values at 1 April 2015</b>	<b>Revised values (where directed)</b>	<b><u>Relevant Licensee</u></b>
LTPS LTPD LTPC (chapter 14)		adjustments to opening tax pool balances	adjustment		tax pool balances.	<a href="#"><u>LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
OLREV  OLRAV (chapter 15)		Legacy adjustments to revenue allowances other than those associated with the DPCR5 RAV Rolling Incentive mechanism  Legacy adjustments to RAV additions	revenue adjustment  RAV balance adjustment	Zero.  Zero.	Legacy revenue adjustment.  Incremental change to 2013/14 and 2014/15 RAV additions.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>
RIREV (chapter 16)		Legacy adjustments associated with the DPCR5 RAV Rolling Incentive mechanism	revenue adjustment	Zero.	Legacy revenue adjustment.	<a href="#"><u>ENWL, NPgN, NPgY, LPN, SPN, EPN, SPD, SPMW, SSEH, and SSES</u></a>

### *Specified financial adjustments*

2.6 Specified financial adjustments relate to adjustment mechanisms set out in the Authority's Strategy decision for RIIO-ED1 - Financial issues supplementary annex - see associated document b. 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.

### *Totex Incentive Mechanism*

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 for actual expenditure levels are contained in chapter 6 of this handbook.

### *Allowed Totex expenditure adjustments*

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 12B of this handbook.

### *Legacy price control adjustments*

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 Years in the legacy period 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 licensee were set; or
- there is an anomalous position, acknowledged by Ofgem and the licensee, that needs to be corrected.

2.10 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**

2.11 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:

Actual expenditure and allowed expenditure

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.

Revenue adjustment

These amounts flow directly to the recalculated base revenue figure for the Regulatory Year to which the adjustment circumstance relates. 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.

Allowed percentage cost of debt

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.

RAV balance adjustment

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.

Tax pool balance adjustment

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*

2.12 During the Annual Iteration Process, 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 may also be included in recalculated base revenue figures for the Regulatory Years concerned.

### *A typical revision*

2.13 The ED1 Price Control Financial Methodologies describe the expected timing sequence for each PCFM Variable Value. For example, in relation to Smart Meter Roll-out costs, the expected sequence would be:

- Activity takes place in Regulatory Year t-2.
- Financial or other values relating to activity 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 that 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.

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



## Part 2

# ED1 Price Control Financial Methodologies

### 3. Pension Scheme Established Deficit revenue allowances - financial adjustment methodologies

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#### Section 1 - Overview

3.1 The Opening Base Revenue Allowances ('PU' values) for the licensee set down in the table at Appendix 1 to CRC 2A (Restriction of Allowed Distribution Network Revenue) include allowances for Pension Scheme Established Deficit (PSED) repair expenditure for each Regulatory Year of the Price Control Period<sup>9</sup>.

3.2 These allowances are represented by the opening EDE values<sup>10</sup> held in the PCFM Variable Values Table for the licensee contained in the ED1 Price Control Financial Model (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.

3.3 The allowance levels will be updated during the Price Control Period by revising EDE values for the purpose 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 Review referred to in this chapter, EDE values are included in full in recalculated base revenue figures in the PCFM under the Annual Iteration Process (ie these values are treated as 100% ~~per cent~~ Fast Money).

#### Price control pension principles

3.5 Ofgem's price control pension principles were set out in Appendix 7 of the Authority's Strategy decision for RIIO-ED1 - Financial issues supplementary annex (see associated document b to which reference should be made). The principles

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<sup>9</sup>Ongoing Pension Service Costs (including Pension scheme administration and Pension Protection Fund (PPF) levy costs) are included as an element of labour costs in RIIO-ED1.

<sup>10</sup> As at 1 April 2015.

were specified in the Authority's final proposals for the DPCR5 Price Control<sup>11</sup> and are:

Principle 1 - Efficient and Economic Employment and Pension Costs

*Customers of network monopolies should expect to pay the efficient cost of providing a competitive package of pay and other benefits, including pensions, to staff of the regulated business, in line with comparative benchmarks.*

Principle 2 - Attributable Regulated Fraction Only

*Liabilities in respect of the provision of pension benefits that do not relate to the regulated business should not be taken into account in assessing the efficient level of costs for which allowance is made in a price control.*

Principle 3 - Stewardship - Ante/Post Investment

*Adjustments may be necessary to ensure that the costs for which allowance is made do not include excess costs arising from a material failure of stewardship.*

Principle 4 - Actuarial Valuation/Scheme Specific Funding

*Pension costs should be assessed using actuarial methods, on the basis of reasonable assumptions in line with current best practice.*

Principle 5 - Under Funding/Over Funding

*In principle, each price control should make allowance for the ex ante cost of providing pension benefits accruing during the period of the control, and similarly for any increase or decrease in the cost of providing benefits accrued in earlier periods resulting from changes in the ex ante assumptions on which these were estimated on a case-by-case basis.*

Principle 6 - Severance - Early Retirement Deficiency Contributions

*Companies will also be expected to absorb any increase (and may retain the benefit of any decrease) in the cost of providing enhanced pension benefits granted under severance arrangements which have not been fully matched by increased contributions.*

## **Pension Scheme Established Deficit**

3.6 For the purposes of CRC 3C (Specified financial adjustments) and this chapter, the term Pension Scheme Established Deficit (PSED) 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).

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<sup>11</sup> [Electricity Distribution Price Control Review Final Proposals – Financial Methodologies](#)



3.7 The Authority may, following bilateral discussions, agree with the licensee, that a different value, a Pension Scheme Established Deficit Adj value (PSED<sub>ADJ</sub>), may be substituted for the PSED for the purposes of the methodology in this chapter provided that:

- a. its use will result in revised EDE values which give rise to allowances which both parties consider to be more appropriate; and
- b. its use for determining any revision to EDE values is without prejudice to:
  - i. the meaning of the term Pension Scheme Established Deficit given in paragraph 3.6; and
  - ii. a reversion to the use of the licensee's PSED in any subsequent determination of revised EDE values for the licensee.

3.8 If the Authority and the licensee decide that PSED<sub>ADJ</sub> should be used in place of PSED for the purposes of determining revised EDE values then:

- a. the PSED<sub>ADJ</sub> will be used in place of the PSED for the licensee as indicated in subsequent paragraphs of this chapter; and
- b. the Authority will include a statement specifying that a PSED<sub>ADJ</sub> value has been used in any direction of a revised EDE value for the purposes of an Annual Iteration Process (see paragraph 3.42).

3.9 Ofgem will determine the licensee's PSED using:

- (i) the triennial actuarial valuation of the pension scheme or schemes that contain the PSED described in paragraph 3.6;
- (ii) the allocation of assets and liabilities in the scheme(s) referred to in subparagraph (i) to the PSED using the Pension Deficit Allocation Methodology published by Ofgem in the Pension RIGs<sup>12</sup>; and
- (iii) its Reasonableness Review with respect to the price control pension principles which could, exceptionally, result in adjustments to the PSED figure.

3.10 Allowances for PSED repair are set at/revised to levels intended to allow the licensee to clear its PSED (by making payments to the pension scheme) over a 15 year period, which began on 1 April 2010 (immediately following the cut-off date) and ends on 31 March 2025.

3.11 The setting of PSED revenue allowances will include adjustments relating to the licensee's actual PSED repair payments history compared to its allowances.

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<sup>12</sup> 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>

With respect to payments made during the DPCR5 Price Control, the policy was set out in subparagraphs (iii) and (iv) of paragraph 1.15 of Appendix 6 of the Authority's Strategy decision for RIIO-ED1 - Financial issues supplementary annex (see associated document b).

3.12 The setting of PSED revenue allowances may include adjustments resulting from Reasonableness Reviews (see paragraphs 3.24 to 3.33).

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

### **Costs and adjustments outside the scope of this chapter**

#### *Pension costs for service after 31 March 2010*

3.14 The following costs are dealt with as Totex expenditure in the RIIO-ED1 price control and therefore fall outside the scope of CRC 3C and this chapter:

- (a) pension costs associated with employee service after the start of the Price Control Period;
- (b) accrued liability costs associated with employee service after the cut-off date (Pension Scheme Incremental Deficit costs); and
- (c) pension scheme administration costs and Pension Protection Fund levy costs.

#### *Legacy true-up for ongoing pension service cost payments made by the licensee during the DPCR5 Price Control*

3.15 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 ongoing pension costs included in its DPCR5 Revenue Allowances and the actual payments made by the licensee to the pension scheme relating to:

- (a) the funding of defined benefit pension schemes in respect of pensionable service that took place on or after 1 April 2010;
- (b) the funding of defined contribution schemes and Personal Accounts associated with Qualifying Workplace Pension Schemes under the provisions of the Pensions Act 2008; and
- (c) pension administration costs.

3.16 Any outstanding adjustment in respect of the true-up described in paragraph 3.15, in relation to outturn expenditure levels for Regulatory years 2013/14 and 2014/15, not taken into account in the calculation of the licensee's Opening Base Revenue Allowances, will be applied in accordance with the DPCR5 Pension ~~legacy~~ adjustment set out in [part 3 chapter 15 section 2\(i\)](#) of this handbook.

## Section 2 - Updating Pension Scheme Established Deficit revenue allowances through the Annual Iteration Process

3.17 The licensee's allowances for PSED repair costs may be updated during the Price Control Period to reflect:

- (a) information contained in pension scheme actuarial valuation reports provided by the licensee to Ofgem;
- (b) the licensee's updated PSED (defined in paragraph 3.6);
- (c) The use of a PSED<sub>ADJ</sub> value, if the licensee agrees this should be used instead of the PSED value referred to in (b) as described in paragraphs 3.7 and 3.8;
- (d) information on the licensee's actual PSED repair payments history contained in price control review information submitted to Ofgem; and
- (e) the outcomes of Reasonableness Reviews (see paragraphs 3.24 to 3.33).

3.18 CRC 3C requires the Authority to determine annually whether any EDE values should be revised. However, subject to paragraph 3.20, the intention is that the values will actually be revised on two occasions during the Price Control Period, driven by the triennial scheme valuation cycle indicated in the timetable in Table 3.1 below and as set out in Tables 3.2 and 3.3. It may, however, be necessary to revise EDE values at different times if, for example:

- (a) a scheme valuation is delayed; or
- (b) the completion of a Reasonableness Review (see paragraphs 3.24 to 3.33) has been delayed because a report commissioned by Ofgem on the reasonableness of costs associated with the licensee's pension deficit position:
  - is outstanding; or
  - has given rise to further review procedures,

3.19 For the avoidance of doubt, the revision of EDE values at a different time because of the delayed completion of a Reasonableness Review (see paragraph 3.18 (b)) will not prevent the revision of EDE values on the two occasions referred to in paragraph 3.18 with respect to adjustments that can be taken into account at those times.

3.20 If any adjustments relating to the licensee's payment history (see paragraph 3.17(d)) for Regulatory Years up to 2014/15, were not fully taken into account in the licensee's opening EDE values, Ofgem will consider whether such adjustments should be included in proposed revisions to EDE values for the purpose of the Annual Iteration Processes that will take place by 30 November 2015 and 30 November 2016.

**Table 3.1 - Expected timetable for EDE value revisions**

Defined benefit pension scheme valuation as at	Expected receipt of Scheme Valuation Data Set by Ofgem	Pension Deficit Allocation Methodology information provided and decision made on whether to use a PSED <sub>ADJ</sub> value	Reasonableness Review completed	Revised EDE values directed for Annual Iteration Process no later than:	EDE values revised for Regulatory Year
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: Information relating to the defined benefit pension scheme valuation as at 31 March 2022 will be taken into account in the setting of Pension Scheme Established Deficit repair cost allowances for the RIIO-ED2 price control.

3.21 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 as 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.

3.22 As stated in paragraph 3.18, the Authority 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 a way that is consistent with the procedures set out in this chapter.

3.23 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 retroactive effect on a previously directed value of the term MOD.

## Reasonableness Reviews

3.24 After receiving the whole (or substantially the whole) of the licensee's Scheme Valuation Data Set (see paragraph 3.34) in respect of each defined benefit pension scheme, Ofgem will commission a report on the costs associated with the licensee's pension deficit position which it will review.

3.25 The report and review referred to in paragraph 3.24 cover overall costs and cost levels associated with over or under-payment (versus allowance) patterns. They do not cover the allocation of assets and liabilities to the PSED using the Pension Deficit Allocation Methodology.

3.26 The commissioning of the report, consideration of it and the carrying out of any further review procedures are, together, termed the Reasonableness Review.

3.27 The Reasonableness Review is referred to in paragraph 3C.5(b) of CRC 3C. The expected completion dates for the Reasonableness Reviews due to take place during the Price Control Period are shown in Table 3.1. The expected completion dates take into account Ofgem's review of the commissioned report, but they do not take into account any further review procedures (see paragraph 3.18).

3.28 Ofgem will consider the report referred to in paragraph 3.24 with respect to:

- (a) the value of the PSED for the licensee;
- (a) existing adjustment factors affecting EDE values that were put in place following a prior Reasonableness Review; and
- (b) the need for any new adjustment factors,

for the purposes of the methodologies in this chapter.

3.29 In most instances, adjustment factors are applied after Base Annual PSED Allowance levels have been derived using an unadjusted PSED value. Exceptionally, the PSED value may be adjusted for the purpose of deriving Base Annual PSED Allowance levels.

### *New or extended adjustment factors*

3.30 Ofgem will only introduce new adjustment factors or extend the scope or effect of existing adjustment factors (including any adjustment to the PSED value used for calculations) if the licensee is an outlier with regard to pension deficit costs in a material respect and that position is:

- (a) to the detriment of consumers; and
- (b) reasonably attributable to the licensee, recognising the responsibilities and independence of pension scheme trustees.

3.31 Before introducing any new adjustment factor or extending the scope or effect of any existing adjustment factor (including any adjustment to the PSED value used for calculations) Ofgem will:

- (a) carry out further review procedures; and
- (b) consult with the licensee.

*Continuation or discontinuation of existing adjustment factors*

3.32 If, after considering the report referred to in paragraph 3.24, Ofgem decides that existing adjustment factors (including any adjustment to the PSED value used for calculations) affecting EDE values that were put in place following a prior Reasonableness Review:

- (a) should continue to be applied; or
- (b) should be discontinued,

it will notify the licensee accordingly. However, subject to paragraph 3.33, a decision of this type will not necessitate further review procedures or consultation.

3.33 If an existing adjustment factor was due to expire and Ofgem considers that it should be continued beyond the expiry date, Ofgem will treat any continuation beyond the expiry date as if it were a new adjustment factor under paragraphs 3.30 and 3.31.

### **Scheme Valuation Data Set**

3.34 The Scheme 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 or an update of the last preceding full triennial valuation, with the asset and liability values projected forward to the full valuation date on the basis set out in the Pension Deficit Allocation Methodology;
- each scheme's statement of funding principles; and
- each scheme's statement of investment principles; and
- any other information reasonably required.

3.35 Pension Deficit Allocation Methodology tables are submitted separately [from the Scheme Valuation Data Set](#).

## **Section 3 – Pension Scheme Established Deficit revenue allowances**

### **Determination of revised EDE values by 30 November 2017**

3.36 Revised EDE values will be determined by 30 November 2017 for each Regulatory Year from 2018/19 to 2022/23 using the process set out in Table 3.2 below.

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

<u>Row</u>	<u>Timing</u>	<u>Event</u>	<u>Value</u>
<i>Determination of component relating to PSED value</i>			
1	By 7 July 2017	i) Ofgem will obtain the licensee's Scheme Valuation Data Set for the valuation of the licensee's defined benefit pension schemes as at 31 March 2016 and commence a Reasonableness Review.	
2	By 31 July 2017	i) Ofgem will be in receipt of price control review information from the licensee for Regulatory Years up to and including 2016/17.	
3	By 30 September 2017	i) The licensee will submit Pension Deficit Allocation Methodology information and its indicative PSED figure as at 31 March 2016 showing the movements from 1 April 2013 to 31 March 2016.	
4	By 31 October 2017	i) Ofgem will: <ul style="list-style-type: none"> <li>a) complete its review of the report commissioned for the purpose of a Reasonableness Review (see paragraph 3.24); and</li> <li>b) subject to the need for any further review procedures and consultation (see paragraphs 3.30 and 3.31) determine the PSED as at 31 March 2016.</li> </ul>	A
4(a)		i) <del>Ofgem will, where relevant</del> agree a PSED <sub>ADJ</sub> value with the licensee (see paragraphs 3.7 and 3.8).	A <sub>1</sub>
5		i) Ofgem will deflate the PSED / PSED <sub>ADJ</sub> to 2012/13 prices in accordance with paragraph 1.7.	B
6		i) Ofgem will establish the remaining deficit repair period as 7 years (2024/25 minus 2017/18).	

Row	Timing	Event	Value
7		<p>i) Ofgem will, subject to point ii), compute the licensee's Base Annual PSED Allowance (C1) in 2012/13 prices as:</p> $C1 = B / ((1-(1+DR)^{-7}) / \text{LN}(1+DR))$ <p>where:</p> <p>DR is the discount rate specified in the licensee's Scheme Valuation Data Set or, if applicable, a different rate determined by Ofgem following a benchmarking review; and</p> <p>LN returns the natural logarithm of 1+DR.</p> <p>ii) If the valuation of the licensee's defined benefit pension schemes as at 31 March 2016 shows a surplus, Ofgem will set values B and C1 to zero and paragraph 3.38 below will apply.</p>	C1
<i>Determination of component relating to payment history in Regulatory Year 2009/10</i>			
8	By 31 October 2017	<p>i) Ofgem will determine the remaining amount (in 2012/13 prices) of any adjustment sum, previously determined, in respect of the licensee's actual payment level in Regulatory Year 2009/10.</p> <p>The remaining amount means the amount of the total adjustment that has not been included in EDE values for Regulatory Years up to and including Regulatory Year 2017/18 and includes a Time Value of Money Adjustment through to Regulatory Year 2018/19.</p>	RC
9	By 31 October 2017	<p>i) Ofgem will calculate the portion (RA1) of the remaining amount referred to in row 8 that should be attributed to each of the seven remaining years of the notional 15-year PSED repair period in 2012/13 prices using the following formula:</p> $RA1 = RC / ((1-(1+DR)^{-7}) / \text{LN}(1+DR))$ <p>where:</p> <p>DR is the discount rate specified in the licensee's Scheme Valuation Data Set or,</p>	RA1



Row	Timing	Event	Value
		if applicable, a different rate determined under the Reasonableness Review; and LN returns the natural logarithm of 1+DR.	
<i>Determination of component relating to adjustments for the licensee's payment history in the DPCR5 Price Control period and elapsed Regulatory Years in the Price Control Period</i>			
10	By 31 October 2017	i) Ofgem will determine the actual PSED repair payments made by the licensee in Regulatory Years 2010/11 to 2016/17 by: (a) obtaining the relevant portion (attributable to the licensee's distribution business) of the actual PSED repair payments made by the licensee in each of those Regulatory Years, excluding any amounts relating to Contingent Asset costs; and (b) converting the resulting value for each of those Regulatory Years to 2012/13 prices in accordance with paragraph 1.7.	D <sub>2010/11</sub> D <sub>2011/12</sub> D <sub>2012/13</sub> D <sub>2013/14</sub> D <sub>2014/15</sub> D <sub>2015/16</sub> D <sub>2016/17</sub>
11		i) Ofgem will obtain the following values, in 2012/13 prices, from the Authority's final determinations for the DPCR5 Price Control and the RIIO-ED1 price control: (a) the licensee's Base Annual PSED Allowances for Regulatory Years 2010/11 to 2014/15; and (b) the licensee's Base Annual PSED Allowances for Regulatory Years 2015/16 and 2016/17 that were included in the calculation of the licensee's Opening Base Revenue Allowances.	E <sub>2010/11</sub> E <sub>2011/12</sub> E <sub>2012/13</sub> E <sub>2013/14</sub> E <sub>2014/15</sub> E <sub>2015/16</sub> E <sub>2016/17</sub>
12		i) Ofgem will calculate the adjustment amount to be applied in respect of the difference between actual PSED repair payments and Base Annual PSED Allowance values for each Regulatory Year	

Row	Timing	Event	Value
		from 2010/11 to 2016/17 by:	
		(a) subtracting the Base Annual PSED Allowance (E) from the payment (D);	$F_{2010/11}$
		(b) factoring in the tax impact in respect of any over/under payment; and	$F_{2011/12}$
		(c) applying a Time Value of Money Adjustment through to Regulatory Year 2018/19.	$F_{2012/13}$
			$F_{2013/14}$
			$F_{2014/15}$
			$F_{2015/16}$
		ii) Ofgem will calculate the total adjustment amount ( $F_{Total}$ ) as the sum of the adjustment amounts for Regulatory Years from 2010/11 to 2016/17.	$F_{2016/17}$
		The value of $F_{Total}$ may be positive or negative.	$F_{Total}$
		The process set out in steps i) and ii) is represented algebraically as:	

$$F_{Total} = \sum_{2010/11}^{2016/17} F$$

where:

$$F_{2010/11} = \frac{(D_{2010/11} - E_{2010/11}) \times (1 - CT_{2010/11}) \times (1 + WACC_{DPCR5})^5 \times (1 + WACC_{2015/16}) \times (1 + WACC_{2016/17}) \times (1 + WACC_{2017/18})}{1 - CT_{2018/19}}$$

$$F_{2011/12} = \frac{(D_{2011/12} - E_{2011/12}) \times (1 - CT_{2011/12}) \times (1 + WACC_{DPCR5})^4 \times (1 + WACC_{2015/16}) \times (1 + WACC_{2016/17}) \times (1 + WACC_{2017/18})}{1 - CT_{2018/19}}$$

$$F_{2012/13} = \frac{(D_{2012/13} - E_{2012/13}) \times (1 - CT_{2012/13}) \times (1 + WACC_{DPCR5})^3 \times (1 + WACC_{2015/16}) \times (1 + WACC_{2016/17}) \times (1 + WACC_{2017/18})}{1 - CT_{2018/19}}$$

$$F_{2013/14} = \frac{(D_{2013/14} - E_{2013/14}) \times (1 - CT_{2013/14}) \times (1 + WACC_{DPCR5})^2 \times (1 + WACC_{2015/16}) \times (1 + WACC_{2016/17}) \times (1 + WACC_{2017/18})}{1 - CT_{2018/19}}$$

$$F_{2014/15} = \frac{(D_{2014/15} - E_{2014/15}) \times (1 - CT_{2014/15}) \times (1 + WACC_{DPCR5}) \times (1 + WACC_{2015/16}) \times (1 + WACC_{2016/17}) \times (1 + WACC_{2017/18})}{1 - CT_{2018/19}}$$

$$F_{2015/16} = \frac{(D_{2015/16} - E_{2015/16}) \times (1 - CT_{2015/16}) \times (1 + WACC_{2015/16}) \times (1 + WACC_{2016/17}) \times (1 + WACC_{2017/18})}{1 - CT_{2018/19}}$$

$$F_{2016/17} = \frac{(D_{2016/17} - E_{2016/17}) \times (1 - CT_{2016/17}) \times (1 + WACC_{2016/17}) \times (1 + WACC_{2017/18})}{1 - CT_{2018/19}}$$

and where:

- CT<sub>20XX/XX</sub> means the actual or, with respect to Regulatory Year 2018/19, prospective rate of Corporation Tax applicable to the licensee in Regulatory Year 20XX/XX, unless the licensee had no modelled taxable profits in the Regulatory Year concerned in which case it takes the value zero;
- WACC<sub>DPCR5</sub> means the Vanilla Weighted Average Cost of Capital applicable to the licensee during the DPCR5 Price Control period; and
- WACC<sub>20XX/XX</sub> means the Vanilla Weighted Average Cost of Capital applicable to the licensee during Regulatory Year 20XX/XX, calculated using the allowed percentage cost of corporate debt (CDE value) for the licensee directed by the Authority for the Regulatory Year concerned.

<u>Row</u>	<u>Timing</u>	<u>Event</u>	<u>Value</u>
13	By 31 October 2017	<p>i) Any adjustment amount (in 2012/13 prices) relating to the licensee's payment history in Regulatory Years 2010/11 to 2016/17, that was included in the calculation of the licensee's Opening Base Revenue Allowances for Regulatory Years 2015/16, 2016/17 and 2017/18 will be subtracted from the value of F<sub>Total</sub> calculated under points i) and ii) in row 12.</p>	RD
14	By 31 October 2017	<p>i) Ofgem will calculate the portion (G1) of the total adjustment amount (F<sub>Total</sub>) that should be attributed to each of the seven remaining years of the notional 15-year PSED repair period in 2012/13 prices using the following formula:</p> $G1 = (F_{Total} - RD) / ((1 - (1 + DR)^{-7}) / LN(1 + DR))$ <p>where:</p> <p>DR is the discount rate specified in the licensee's Scheme Valuation Data Set</p> <p>or, if applicable, a different rate determined under the Reasonableness Review; and</p> <p>LN returns the natural logarithm of 1+DR.</p>	G1

*Determination of component relating to adjustment factors resulting from*

<u>Row</u>	<u>Timing</u>	<u>Event</u>	<u>Value</u>
<i>Reasonableness Reviews</i>			
15	By 31 October 2017	<p>i) After considering the report on the costs associated with the licensee's pension deficit position referred to in paragraph 3.24, Ofgem will decide whether any existing adjustment factors affecting EDE values that were put in place following a prior Reasonableness Review:</p> <p>(a) should continue to be applied; or</p> <p>(b) should be discontinued (with or without retroactivity).</p> <p>ii) Having made the decision referred to in point i), Ofgem will calculate the adjustment that should be attributed to each of the seven remaining years of the notional 15-year PSED repair period in 2012/13 prices, having regard to the terms on which the adjustment factor was originally applied.</p> <p>If, after considering the report on the costs associated with the licensee's pension deficit position referred to in paragraph 3.24, Ofgem decides that a new adjustment factor should be applied or that the scope or effect of an existing adjustment factor should be extended, it will follow the process described in paragraphs 3.30 and 3.31. In such a case, as part of the further review and consultation process, Ofgem will consider the basis and timing for any revision of EDE values for the licensee (see paragraph 3.18).</p>	AF1
<i>Calculation of revised EDE values</i>			
16		<p>i) Ofgem will calculate the revised EDE value for each Regulatory Year from 2018/19 to 2022/23 as:</p> $\text{EDE} = \text{C1} + \text{RA1} + \text{G1} + \text{AF1}.$	EDE

3.37 The adjustments relating to the licensee's payment history (see rows 8 to ~~13-14~~ in Table 3.2) address a position where the licensee has paid amounts to the pension scheme in particular Regulatory Years that are greater than or lower

than the Base Annual PSED Allowances it was given for the Regulatory Years concerned.

### *Scheme surplus*

3.38 If the difference between the assets and corresponding liabilities referred to in paragraph 3.6 represents a surplus position for the PSED as at 31 March 2016, then values for C1 (see row 7 in Table 3.2) for Regulatory Years from 2018/19 onwards will be revised to zero pending the next review process set out in Table 3.3. However, if applicable, the calculation of adjustment components relating to the licensee's payment history and to adjustment factors resulting from Reasonableness Reviews would still be carried out, giving values for RA1, G1 and AF1 respectively. Those values (which may be negative) would, in that circumstance, give the value of the term EDE for each Regulatory Year from 2018/19 to 2022/23 pending the next review process. The policy position with regard to pension scheme surpluses is set out in paragraphs 1.11 to 1.14 of the Authority's Strategy decision for RIIO-ED1 - Financial issues supplementary annex - see associated document b.

### **Determination of revised EDE values by 30 November 2020**

3.39 Revised EDE values will be determined by 30 November 2020 for Regulatory Years 2021/22 and 2022/23 using the process set out in Table 3.3 below.

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

<u>Row</u>	<u>Timing</u>	<u>Event</u>	<u>Value</u>
<i>Determination of component relating to PSED value</i>			
1	By 7 July 2020	i) Ofgem will obtain the licensee's Scheme Valuation Data Set for the valuation of the licensee's defined benefit pension schemes as at 31 March 2019 and commence a Reasonableness Review.	
2	By 31 July 2020	i) Ofgem will be in receipt of price control review information from the licensee for Regulatory Years up to and including 2019/20.	
3	By 30 September 2020	i) The licensee will submit Pension Deficit Allocation Methodology information and its indicative PSED figure as at 31 March 2019 showing the movements from 1 April 2016 to 31 March 2019.	

<u>Row</u>	<u>Timing</u>	<u>Event</u>	<u>Value</u>
4	By 31 October 2020	<p>i) Ofgem will:</p> <p>a) complete its review of the report commissioned for the purpose of a Reasonableness Review (see paragraph 3.24); and</p> <p>b) subject to the need for any further review procedures and consultation (see paragraphs 3.30 and 3.31) determine the PSED as at 31 March 2019.</p>	A
4(a)		Ofgem will, where relevant, agree a PSED <sub>ADJ</sub> value with the licensee (see paragraphs 3.7 and 3.8).	A <sub>1</sub>
5		i) Ofgem will deflate the PSED / PSED <sub>ADJ</sub> to 2012/13 prices in accordance with paragraph 1.7.	B
6		i) Ofgem will establish the remaining deficit repair period as 4 years (2024/25 minus 2020/21).	
7		<p>i) Ofgem will, subject to point ii), compute the licensee's Base Annual PSED Allowance (C2) in 2012/13 prices as:</p> $C2 = B / ((1-(1+DR)^{-4}) / \ln(1+DR))$ <p>where:</p> <p>DR is the discount rate specified in the licensee's Scheme Valuation Data Set or, if applicable, a different rate determined by Ofgem following a benchmarking review; and</p> <p>LN returns the natural logarithm of 1+DR.</p> <p>ii) If the valuation of the licensee's defined benefit pension schemes as at 31 March 2019 shows a surplus, Ofgem will set values B and C2 to zero and paragraph 3.41 below will apply.</p>	C2
<i>Determination of component relating to payment history in Regulatory Years to 2016/17</i>			
8	By 31 October 2020	<p>i) (in 2012/13 prices) Ofgem will determine the remaining amount of any adjustment sums, previously determined, in respect of the licensee's actual payment levels in Regulatory</p>	RC

Row	Timing	Event	Value
		<p>Years from 2009/10 to 2016/17.</p> <p>The remaining amount means the amount of the total adjustment that has not been included in EDE values for Regulatory Years up to and including Regulatory Year 2020/21 and includes a Time Value of Money Adjustment through to Regulatory Year 2021/22.</p>	
9	By 31 October 2020	<p>i) Ofgem will calculate the portion (RA2) of the remaining amount referred to in row 8 that should be attributed to each of the four remaining years of the notional 15-year PSED repair period in 2012/13 prices using the following formula:</p> $RA2 = RC / ((1-(1+DR)^{-4}) / LN(1+DR))$ <p>where:</p> <p>DR is the discount rate specified in the licensee's Scheme Valuation Data Set</p> <p>or,</p> <p>if applicable, a different rate determined under the Reasonableness Review; and</p> <p>LN returns the natural logarithm of 1+DR.</p>	RA2
<p><i>Determination of component relating to adjustments for the licensee's payment history in Regulatory Years 2017/18, 2018/19 and 2019/20</i></p>			
10	By 31 October 2020	<p>i) Ofgem will determine the actual PSED repair payments made by the licensee in Regulatory Years 2017/18, 2018/19, and 2019/20 by:</p> <p>(a) obtaining the relevant portion (attributable to the licensee's distribution of business) of the actual PSED repair payments made by the licensee in each of those Regulatory Years, excluding any amounts relating to Contingent Asset costs; and</p> <p>(b) deflating the resulting value for each of those Regulatory Years to 2012/13 prices in accordance with paragraph</p>	<p><math>D_{2017/18}</math></p> <p><math>D_{2018/19}</math></p> <p><math>D_{2019/20}</math></p>





$$F_{2018/19} = \frac{(D_{2018/19} - E_{2018/19}) \times (1 - CT_{2018/19}) \times (1 + WACC_{2018/19}) \times (1 + WACC_{2019/20}) \times (1 + WACC_{2020/21})}{1 - CT_{2021/22}}$$

$$F_{2019/20} = \frac{(D_{2019/20} - E_{2019/20}) \times (1 - CT_{2019/20}) \times (1 + WACC_{2019/20}) \times (1 + WACC_{2020/21})}{1 - CT_{2021/22}}$$

and where:

- $CT_{20XX/XX}$  means the actual or, with respect to Regulatory Year 2021/22, prospective rate of Corporation Tax applicable to the licensee in Regulatory Year 20XX/XX, unless the licensee had no modelled taxable profits in the Regulatory Year concerned in which case it takes the value zero; and
- $WACC_{20XX/XX}$  means the Vanilla Weighted Average Cost of Capital applicable to the licensee during Regulatory Year 20XX/XX, calculated using the \_\_\_\_\_ allowed percentage cost of corporate debt (CDE value) for the licensee \_\_\_\_\_ directed by the Authority for the Regulatory \_\_\_\_\_ Year concerned.

Row	Timing	Event	Value
13		<p>i) Ofgem will calculate the portion (G2) of the total adjustment amount (<math>F_{Total}</math>) that should be attributed to each of the four remaining years of the notional 15-year PSED repair period in 2012/13 prices using the following formula:</p> $G2 = F_{Total} / ((1 - (1 + DR)^{-4}) / LN(1 + DR))$ <p>where:</p> <p>DR is the discount rate specified in the licensee's Scheme Valuation Data Set</p> <p>or,</p> <p>if applicable, a different rate determined under the Reasonableness Review; and</p> <p>LN returns the natural logarithm of 1+DR.</p>	G2

*Determination of component relating to adjustment factors resulting from*

<i>Reasonableness Reviews</i>			
14	By 31 October 2020	<p>i) After considering the report on the costs associated with the licensee's pension deficit position referred to in paragraph 3.24, Ofgem will decide whether any existing adjustment factors affecting EDE values that were put in place following a prior Reasonableness Review:</p> <p>(a) should continue to be applied; or</p> <p>(b) should be discontinued (with or without retroactivity).</p> <p>ii) Having made the decision referred to in point i),</p> <p>Ofgem will calculate the adjustment that should be attributed to each of the four remaining years of the notional 15-year PSED repair period in 2012/13 prices, having regard to the terms on which the adjustment factor was originally applied.</p> <p>If, after considering the report on the costs associated with the licensee's pension deficit position referred to in paragraph 3.24, Ofgem decides that a new adjustment factor should be applied or that the scope or effect of an existing adjustment factor should be extended, it will follow the process described in paragraphs 3.30 and 3.31. In such a case, as part of the further review and consultation process, Ofgem will consider the basis and timing for any revision of EDE values for the licensee (see paragraph 3.18).</p>	AF2
<i>Calculation of revised EDE values</i>			
15		<p>i) Ofgem will calculate the revised EDE value for Regulatory Years 2021/22 and 2022/23 as:</p> $\text{EDE} = \text{C2} + \text{RA2} + \text{G2} + \text{AF2}.$	EDE

3.40 The adjustments relating to the licensee's payment history (see rows 8 to 13 in Table 3.3) address a position where the licensee has paid amounts to

pension scheme trustees in particular Regulatory Years that are greater than or lower than the Base Annual PSED Allowances it was given for the Regulatory Years concerned.

#### *Scheme surplus*

3.41 If the difference between the assets and corresponding liabilities referred to in paragraph 3.6 represents a surplus position for the PSED as at 31 March 2019, then values for C2 (see row 7 in Table 3.3) for Regulatory Years from 2021/22 onwards will be revised to zero pending the next review process. However, if applicable, the calculation of adjustment components relating to the licensee's payment history and to adjustment factors resulting from Reasonableness Reviews would still be carried out, giving values for RA2, G2 and AF2 respectively. Those values (which may be negative) would, in that circumstance, give the value of the term EDE for Regulatory Years 2021/22 and 2022/23 pending the next review process. The policy position with regard to pension scheme surpluses is set out in paragraphs 1.11 to 1.14 of the Authority's Strategy decision for RIIO-ED1 - Financial issues supplementary annex - see associated document b.

#### **Direction of revised EDE values**

3.42 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 CRC 3C (but see also paragraphs 3.18 and 3.20).

### **Section 4 - Processing of revised EDE values under the Annual Iteration Process**

3.43 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.

3.44 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 retroactive effect on a previously directed value of the term MOD.

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

## 4. Tax liability allowances - financial adjustment methodologies

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### Section 1 - Overview

4.1 The Opening Base Revenue Allowances ('PU' values) for the licensee set down in the table at Appendix 1 to CRC 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 CRC 3C (Specified financial adjustments) provides for adjustments to be made to the licensee's tax liability allowances<sup>13</sup> 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 subparagraphs 4.1 (a) and (b) are referred to as 'tax trigger events' and the methodology for adjustments that may result from these is set out in section 2 of this chapter. Adjustments that are the result of changes to the factors referred to at subparagraph 4.1(c) are referred to as 'tax claw-backs' and the methodology for such adjustments is set out in section 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 4.11) 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 claw-backs ('TGIE values').

4.4 TTE values represent £m amounts in 2012/13 prices. TGIE values represent £m amounts in nominal prices for the Regulatory Years to which they relate. ~~TGIE values are the only PCFM Variable Values that are in nominal~~

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<sup>13</sup> References in this chapter to tax liabilities are references to liabilities for corporation tax only and not to any other type of taxation.

~~prices~~. Functionality in the PCFM ensures that the effect of revising TGIE values is correctly reflected in the calculation of values for the term MOD. As at 1 April 2015, the TTE and TGIE values for the licensee, for each Regulatory Year will be zero. Part B of CRC 3C 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 4.7, 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 retroactive 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 section 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 claw-back adjustments, ~~revised~~ TGIE values (determined under the methodology in section 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.

4.7 It should be noted that underlying tax liability allowances for the licensee within the PCFM may 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*

4.8 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 LTPC PCFM Variable Values. These adjustments are covered in chapter 14. The allocation of component elements of allowed DPCR5 Price Control totex expenditure to capital allowance pools and revenue expenditure in the PCFM was fixed at the outset of the Price Control Period and will not be updated during the Price Control Period.

### **Price bases for tax calculations**

4.9 The PCFM works predominantly in constant 2012/13 prices and the methodologies in this chapter provide for values that are expressed in nominal

prices to be deflated to 2012/13 prices in accordance with paragraph 1.7 in chapter 1 where necessary.

4.10 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**

4.11 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 that 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**

4.12 For the purposes of the methodology set out in section 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 (Claw-back of tax benefit due to excess gearing)<sup>14</sup>.

4.13 For the purposes of the methodology set out in section 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.

## **Section 2 - Adjustments driven by tax trigger events - methodology**

4.14 The methodology set out in this section provides for the licensee's tax liability allowances to be adjusted (subject to a threshold described below) to take

<sup>14</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=49&refer=Networks> and as amended for the treatment of hybrid financial instruments

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**

4.15 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, that have been enacted into law; and
- changes to capital allowance rates applicable to one or more Regulatory Years, that have been enacted into law.

#### 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<sup>15</sup> 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.

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

4.17 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.

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<sup>15</sup> The tax liability which would be modelled if the event was taken into account.



## Materiality threshold and 'deadband'

4.18 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.

4.19 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 allowance 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.

4.20 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.

4.21 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.

4.22 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<sup>16</sup>.

4.23 The accounting framework to be applied by the licensee for the purpose of computing tax liabilities is either:

- EU-IFRS, if adopted for use by the licensee<sup>17</sup>; or
- UK GAAP under Financial Reporting Standard 102.

## Notification of tax trigger events

### *Type A trigger events*

4.24 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

<sup>16</sup> Section 385 of the Companies Act 2006 refers.

<sup>17</sup> Including the provisions of IFRS 1 (First-time Adoption of International Financial Reporting Standards) where applicable.

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.

4.25 If, after receiving the notification referred to in paragraph 4.24, 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.

4.26 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*

4.27 The licensee must notify Ofgem on or before 30 September in each Regulatory Year t-1 of all the Type B trigger events that it has become aware of by that time, except those that have been previously notified. This requirement applies equally to events that could be expected to increase or to reduce the licensee's tax liability allowances.

4.28 For the purpose of complying with the requirement set out in paragraph 4.27, the licensee must seek to ensure that it identifies and records Type B trigger events.

4.29 The notification referred to in paragraph 4.27 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 4.39;
- (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 Regulatory Accounts.

4.30 The licensee's notification should also state whether it considers that the materiality threshold (see paragraph 4.18) 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.

4.31 Ofgem will review any notifications given to it by the licensee under paragraph 4.27 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 Auditor, to assist in confirming the appropriateness and accuracy of the licensee's calculations.

4.32 Ofgem will inform the licensee by 31 October 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.

4.33 In deciding which of the actions set out in paragraph 4.32 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 4.43).

4.34 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.

4.35 Ofgem will also notify the licensee by 31 October 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.

4.36 If Ofgem has not finished considering any matters raised by the licensee under paragraph 4.34 or paragraph 4.35 before giving the licensee the Notice required under paragraph 3C.23 of CRC 3C, the Authority will through business correspondence, apprise the licensee of any provisionality it has applied

in determining the revised TTE values that it proposes to direct, that might entail a further revision to those values for use in the next Annual Iteration Process.

### **Logging of trigger events**

4.37 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*

4.38 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.

4.39 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 CRC 4A (Governance of ED1 Price Control Financial Instruments)) 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 in the PCFM Variable Values Table for the licensee 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 trigger 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 Tax Trigger 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 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 (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.

4.40 Subject to paragraph 4.43, 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), the Authority will direct that the TTE values concerned are to be revised in accordance with the process set out in Part D of CRC 3C (Specified financial adjustments) and referred to below.

4.41 The two stage calculation process referred to in steps (vii) and (ix) in paragraph 4.39 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.

4.42 Once a tax trigger event has occurred in any year, the tax trigger calculation, including the materiality assessment, will need to be run in respect of all subsequent Annual Iteration Processes, even if no further tax trigger event has occurred.

4.43 The process set out in paragraph 4.39 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.

*Direction of revised TTE values*

4.44 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 that it proposes to direct in accordance with Part D of CRC 3C.

4.45 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.

4.46 The procedure for the Authority's direction of revised TTE values is set out in Part D of CRC 3C.

**Section 3 - Adjustments driven by Gearing levels and corporate debt interest costs ('tax claw-back') - methodology**

4.47 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.

4.48 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 section. 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**

4.49 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 at row 233 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 claw-back considerations and which is referred to in the remainder of this section.

4.50 After 30 September in each Regulatory Year t-1, 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 CRC 4A)<sup>18</sup>:

- (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.

4.51 The indicative RAV balance referred to in paragraph 4.50(ii) will then be inflated to year-end prices for Regulatory Year t-2, using the March/April RPI Factor for Regulatory Year t-2.

4.52 Ofgem will obtain from the tax claw-back worksheet in the licensee's price control cost information return the reported figures for:

- (i) adjusted net debt as at 31 March in Regulatory Year t-2, in nominal prices; and
- (ii) tax deductible net interest paid during Regulatory Year t-2, in nominal prices, measured on an accruals basis.

4.53 The tax-deductible net interest paid figure referred to in paragraph 4.52(ii) is ascertained on an accruals basis. The criteria for reporting the figures are set out in the RIGs.

#### Applicability tests

4.54 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*

4.55 Ofgem will divide the licensee's net debt figure as at 31 March in Regulatory Year t-2 (see paragraph 4.52(i)) by the licensee's indicative PCFM RAV balance (see paragraph 4.51) as at 31 March in Regulatory Year t-2 to calculate the licensee's Gearing ratio.

4.56 If the calculated Gearing ratio established under paragraph 4.55, expressed as a percentage, is greater than the notional level of Gearing for the licensee (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.

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<sup>18</sup> 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 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.

*Positive benefit test*

4.57 Ofgem will subtract the modelled figure for tax-deductible interest payable by the licensee in Regulatory Year t-2 (see paragraph 4.50(i)) from the licensee's reported figure for tax deductible net interest paid during Regulatory Year t-2 (see paragraphs 4.52(ii) and 4.53). For the purpose of this calculation, amounts of interest payable are treated as positive numbers.

4.58 If the result of the calculation set out in paragraph 4.57 is a positive value, demonstrating a positive benefit, then a tax claw-back 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 in 2012/13 prices. 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 4.11).

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

4.60 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. As noted at paragraph 4.4, unlike **most** other PCFM Variable Values, TGIE values are directed in nominal prices for the Regulatory Year to which they relate. This characteristic is appropriately handled by functionality in the PCFM.

*Re-performance of TGIE determinations*

4.61 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 4.49 as a result of an Annual Iteration Process.

*Interaction with unutilised regulatory tax losses*

4.62 If for any Regulatory Year a tax claw-back adjustment is applicable to the licensee but the licensee has no modelled profits subject to tax, then the TGIE value calculated under paragraph 4.58 is grossed up with reference to the corporation tax rate 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 section 4 below.



### Direction of TGIE values

4.63 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.

4.64 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, Ofgem will follow the procedure in the next paragraph to determine revisions to the TGIE values concerned for use in the next Annual Iteration Process.

4.65 Ofgem will re-perform the Gearing level test and, if applicable, the positive tax benefit test, to determine any revisions to the TGIE value(s) for the Regulatory Year(s) 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.

4.66 If a revised TGIE value is directed for a Regulatory 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 the 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.

4.67 The procedure for the Authority's direction of revised TGIE values is set out in Part D of CRC 3C.

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

### *TTE and TGIE values*

4.68 Subject to paragraph 4.72, a positive TTE value will increase the recalculated base revenue figure for the Regulatory Year concerned by the same amount.

4.69 Subject to paragraph 4.72, a negative TTE value will decrease the recalculated base revenue figure for the Regulatory Year concerned by the equivalent amount.

4.70 Subject to paragraph 4.72, a positive TGIE value will decrease the recalculated base revenue figure for the Regulatory Year concerned by:

- the amount of the value<sup>19</sup>; and

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<sup>19</sup> Subject to a price base adjustment factor applied under the PCFM functionality (see paragraph 1.7 in chapter 1).

- a 'tax allowance on tax allowance' factor calculated by functionality within the PCFM (see paragraph 4.6).

4.71 As noted at paragraph 4.60, TGIE values can only be zero or positive.

4.72 If there is any unutilised regulatory tax losses balance for the licensee, any change to recalculated base revenue under paragraph 4.68, 4.69 or 4.70 will be partially or fully abated to take account of that balance and the regulatory tax losses balance held within the PCFM will be updated accordingly.

4.73 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.

## 5. Corporate debt allowed percentage cost - financial adjustment methodology

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### Section 1 - 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)<sup>20</sup> 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 basis for updating the cost of debt percentage value by revising PCFM Variable Values for the licensee's allowed percentage cost of corporate debt ('CDE' values) is established in CRC 3C (Specified financial adjustments). CRC 3C requires revised CDE values to be determined in accordance with the methodology in this chapter.

#### **'Tromboning' of index averaging period for corporate debt cost percentage calculations**

5.4 The averaging period for the index of debt costs referred to in paragraph 5.2 will commence with an eleven year period<sup>21</sup>, and then extend by one year as each Regulatory Year of the Price Control Period elapses. This means that the relatively high values contained in the initial ten year indexation period will have an ongoing influence on calculated CDE values.

### Section 2 - Methodology for determining revised PCFM Variable Values for the cost of corporate debt

5.5 The ED1 Price Control Financial Model (PCFM) in its state as at 1 April 2015 includes opening CDE values for the licensee for every Regulatory Year of the Price Control Period.

5.6 Revised CDE values will be determined by Ofgem using the pounds sterling indices of bonds issued by non-financial institutions that have a remaining

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<sup>20</sup> See Glossary

<sup>21</sup> A ten year period having been used to set opening CDE values at the outset of the Price Control Period.

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 methodologies 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<sup>22</sup> to be used in relation to the particular Annual Iteration Process:

<b>Annual Iteration Process taking place not later than:</b>	<b>Trading days period</b>	<b>Regulatory Year t from which revised CDE value applies</b>
30 November 2015	1 November 2004 to 31 October 2015	2016/17
30 November 2016	1 November 2004 to 31 October 2016	2017/18
30 November 2017	1 November 2004 to 31 October 2017	2018/19
30 November 2018	1 November 2004 to 31 October 2018	2019/20
30 November 2019	1 November 2004 to 31 October 2019	2020/21
30 November 2020	1 November 2004 to 31 October 2020	2021/22
30 November 2021	1 November 2004 to 31 October 2021	2022/23

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:

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<sup>22</sup> Trading days as published in the Markit iBoxx® database

- (i). A 10+ index                      Markit iBoxx series reference: DE000A0JY837; and
- (ii). BBB 10+ index                 Markit iBoxx series reference: DE000A0JZAH1

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 ("iBoxx") 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:

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

where:

- $\pi$      is the Ofgem imputed breakeven inflation figure.
- $i$      is the 'Yield From British Government Securities, 10 Year Nominal Zero Coupon' – series reference IUDMNZC expressed as a Decimal Percentage; and
- $r$      is the 'Yield From British Government Securities, 10 Year Real Zero Coupon' – series reference IUDMRZC expressed as a decimal percentage.

The above series will be sourced from the statistics page on the Bank of England's website.<sup>23</sup> 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

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<sup>23</sup> <http://www.bankofengland.co.uk>

England's breakeven inflation figure obtained under Step 3, using the following formula:

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

where:

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

*iBoxx* is the average of the annual yield figures obtained under Step 2 expressed as a Decimal Percentage; and

$\pi$  is the Ofgem imputed breakeven inflation figure obtained under Step3.

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 and stated to two decimal places constitutes the revised PCFM Variable Value for the cost of corporate debt (CDE value) for Regulatory year t and subsequent Regulatory Years.

### **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.

### **Section 3 - Use of revised PCFM Variable Values in the Annual Iteration Process**

5.11 The Authority will direct revised CDE values for Regulatory Year t and subsequent Regulatory Years by no later than 30 November in each Regulatory

Year t-1 in accordance with Part D of CRC 3C. Notice of proposed revised values will be given to the licensee at least 14 days before the date of the direction. Ofgem will provide the licensee with a copy of the spreadsheet used to calculate revised CDE values at the same time as giving the notice.

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 by 30 November in each Regulatory Year.

## 6. Totex Incentive Mechanism – financial adjustment methodology

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### Section 1 - Totex Incentive Mechanism

6.1 The term Totex Incentive Mechanism means the incentive mechanism described in this section. The term Totex Incentive Mechanism Adjustment means an adjustment to the Totex figure used in the fast/slow money modelling of recalculated base revenue figures under the Annual Iteration Process.

6.2 The licensee's Opening Base Revenue Allowances will have been modelled on the basis that actual Totex expenditure levels are expected to equal allowed Totex expenditure levels (allowances). When 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.

6.3 The ED1 Price Control Financial Model (PCFM) contains values for both actual Totex expenditure and allowed Totex expenditure levels that, 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*

6.4 Actual Totex expenditure is divided into seven subdivisions to facilitate varying tax pool treatments under the Annual Iteration Process calculations (see Table 6.2). Before making any change to the categories of costs included in each subdivision through the operation of standard condition 46 (Regulatory Instructions and Guidance) of the electricity distribution standard licence conditions, as part of the consultation process under Part C of that condition the Authority will consult with the licensee on whether, if such a change were made, it would also be appropriate to make changes to the financial treatment of such cost category under the Annual Iteration Process.

6.5 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  $MOD_t$ .

6.6 CRC 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.

#### *Allowed Totex expenditure*

6.7 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	<a href="#">Relevant Lic</a>
CRC 3F	UCHVP UCEPS UCSSW <del>UCHR</del> <u>UUCRE</u> <u>UCLB</u>	Uncertain Costs High Value Projects Uncertain Costs Enhanced Physical Site Security Uncertain Costs Specified Street Works Uncertain Costs Rail electrification Works <u>Uncertain Costs Link Boxes</u>	7	<a href="#">ENWL, NPgN, LPN, SPN, EPN, SPMW, SSEH, SSES</a>
<a href="#">CRC 3F</a>	<a href="#">UCSFE</a> <a href="#">UCCPC</a> <a href="#">UCSC</a>	<a href="#">Uncertain Costs Shetland Uncertain Energy</a> <a href="#">Uncertain Costs Shetland Competitive Process</a> <a href="#">Uncertain Costs Subsea Cables</a>	<a href="#">7</a>	<a href="#">SSEH</a>
CRC 3E	SMAE	Smart Meter Roll-out Costs	8	<a href="#">ENWL, NPgN, LPN, SPN, EPN, SPMW, SSEH, SSES</a>
CRC 3G	LRRC	Load Related Expenditure	9	<a href="#">ENWL, NPgN, LPN, SPN, EPN, SPMW, SSEH, SSES</a>
CRC 3J	VAA	Visual Amenity (undergrounding)	10	<a href="#">ENWL, NPgN, LPN, SPN, EPN, SPMW, SSEH, SSES</a>
CRC 3H	WSCC	Worst Served Customers	11	<a href="#">ENWL, NPgN, LPN, SPN, EPN, SPMW, SSEH, SSES</a>
CRC 3D	IRM	Innovation Roll-out	12	<a href="#">ENWL, NPgN, LPN, SPN, EPN, SPMW, SSEH, SSES</a>
<a href="#">CRC 3L</a>	<a href="#">UCMC</a>	<a href="#">Moorside Costs</a>	<a href="#">12B</a>	<a href="#">ENWL</a>

**Description of the Totex Incentive Mechanism (TIM)**

6.8 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 (TISR) for the licensee. The TISR is a percentage figure specified in CRC 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  $(1 - \text{TISR})$ . 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.

6.9 The TIM uses the licensee's actual Totex expenditure values for Regulatory Year t-2, reported to Ofgem in accordance with Regulatory Instructions and Guidance (RIGs). It adjusts allowed revenue via the MOD term with adjustments to MOD in year t relating to performance in year t-2. The incentive mechanism therefore operates with a ~~two~~-two-year lag.

6.10 Totex, once ascertained under the TIM, is apportioned using the Totex Capitalisation Rate 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 and subsequent Regulatory Years.

6.11 The Totex Capitalisation Rate for the licensee for the relevant Regulatory Year is specified at Appendix 1 to CRC 3B and is a fixed input value for the licensee in the PCFM. The rates are fixed for the Price Control Period.

6.12 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*

6.13 Simplified, 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 $(1 - 0.7) \times 20$	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

6.14 The reduced Totex amount for fast/slow money treatment in scenario 1 represents a claw-back 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

6.15 Under the Annual Iteration Process, Ofgem will revise the opening values for actual Totex expenditure contained in the PCFM using the methodology set out in this chapter to reflect outturn values (in 2012/13 prices) reported annually by the licensee in accordance with the RIGs. The normal revision cycle will be:-

Regulatory Year t-2:	Totex expenditure incurred.
Regulatory Year t-1:	Outturn expenditure levels reported to Ofgem in accordance with the RIGs.
Regulatory Year t-1:	31 October – cut off date for data relating to actual Totex expenditure levels to be taken into account in determination of revised PCFM Variable Values.
Regulatory Year t-1:	Authority gives licensee at least 14 days’ notice of proposed revisions to PCFM Variable Values.
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 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.

6.16 Allowed Totex expenditure levels will be revised in accordance with the provisions of applicable Charge Restriction 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 paragraph 6.2 of this chapter.

6.17 It should be noted that:

- each Annual Iteration Process reruns the TIM calculations for each Regulatory Year of the Price Control Period 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 a 2012/13 price base and applies a Time Value of Money Adjustment when the revision of a PCFM Variable Value for a particular Regulatory Year is reflected in the value of the term MOD for a later Regulatory Year.

### **Total expenditure (Totex)**

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

- costs relating to De Minimis Business activities as defined in Standard Condition 29 (Restriction of activity and financial ring-fencing of the Distribution Business) of the licence;
- costs relating to Directly Remunerated Services;
- pension deficit repair payments relating to the Pension Scheme 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 Disposal proceeds from the sale of network assets as further specified in the RIGs by the licensee are treated as negative Totex amounts.

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

6.21 It should be noted that CRC 5C (Directly Remunerated Services) and CRC 5F (Treatment of income from recovery in respect of Relevant Theft of Electricity) 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.

## Section 2 - Determination of PCFM Variable Value revisions for actual Totex expenditure

6.22 Subject to paragraph 3B.17 of CRC 3B, 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 (after deflation to 2012/13 prices) reported by the licensee in accordance with the RIGs.

6.23 In accordance with the processes set out in the licence and this handbook, the Authority can determine and direct revised PCFM Variable Values for actual Totex expenditure for Regulatory Years in the Price Control Period 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.

**Table 6.2 – PCFM Variable Values for actual Totex**

<b>PCFM Variable Value</b>	<b>Totex subdivision</b>
ALC	Actual load-related capex expenditure
ANLR	Actual non-load-related capex expenditure – asset replacement
ANLO	Actual non-load-related capex - other
AFE	Actual faults expenditure
ARP	Actual 100% 'revenue pool' expenditure
ACO	Actual controllable opex expenditure
TRE	Actual tree cutting expenditure

6.24 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. In

particular it should be noted that ACO values will include negative components representing:

- (a) the licensee's Incremental Revenue from charges levied in respect of Directly Remunerated Services provided within category DRS8 for the Regulatory Year concerned, as specified in CRC 5C (Directly Remunerated Services) for the Regulatory Year concerned; and
- (b) the licensee's Income from Theft Recovery for the Regulatory Year concerned, as specified in CRC 5F (Treatment of income from recovery in respect of Relevant Theft of Electricity).

### Section 3 - Notification and direction of revised PCFM Variable Values

6.25 The PCFM is a constituent part of CRC 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 Table 6.2 above.

6.26 During each Regulatory Year t-1, the Authority will determine revised PCFM Variable Values for the licensee relating to actual Totex expenditure. Part B of CRC 3B<sup>7</sup> 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.

6.27 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** notice of the proposed values as soon as practicably possible in Regulatory Year t-1.

6.28 Paragraph 3B.17 of CRC 3B says that if, for any reason in any Regulatory Year t-1, the Authority does not make a direction in relation to revised actual Totex values by 30 November, it will direct the value or values concerned as soon as is reasonably practicable.

6.29 The Authority will then carry out the Annual Iteration Process in accordance with CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model) - see Chapter 1.

## 7. Uncertain costs allowed expenditure – financial adjustment methodology [applicable to ENWL, NPgN, NPgY, SPD, SPMW, AND SSES only]

### Section 1 - Overview

7.1 At the outset of the Price Control Period, levels of allowed expenditure for the following categories of uncertain costs were set on a provisional basis because of uncertainties about requirements:

- (a) High Value Project Costs;
- (b) Enhanced Physical Site Security Costs;
- (c) Specified Street Works Costs;
- (d) Rail Electrification Costs; and
- (e) Link Box Costs; ~~and~~
- ~~(f) Shetland Uncertain Energy Costs;~~
- ~~(g) Shetland Competitive Process Costs; and~~
- ~~(h) Subsea Cable Costs.~~

~~7.2 Categories (f), (g), and (h) set out in paragraph 7.1 are applicable to Scottish Hydro Electric Power Distribution plc only.~~

~~7.37.2~~ The licensee's Opening Base Revenue Allowances were modelled using the provisional levels of allowed expenditure referred to in paragraph 7.1.

~~7.47.3~~ 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 Values associated with each uncertain cost activity should be revised.

~~7.57.4~~ At the start of the 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.

~~7.67.5~~ Opening levels of allowed expenditure for the licensee for the following cost categories are set out in appendices to CRC\_3F as shown below:

- High Value Projects Costs - Appendix 1; and
- Enhanced Physical Site Security Costs – Appendix 2; ~~and~~  
~~Shetland Uncertain Energy Costs – Appendix 6; and~~
- ~~Shetland Competitive Process Costs – Appendix 7.~~

~~7.77.6~~ Opening levels of allowed expenditure for the licensee for the following cost categories are set at zero:

- Specified Street Works Costs;
- Rail Electrification Costs; and

- Link Box Costs ~~and~~  
~~Subsea Cable Costs.~~

~~7.87.7~~ The PCFM Variable Values for the uncertain cost categories can be revised so that they continue to match allowed expenditure levels following any relevant adjustments under the provisions of CRC 3F and this chapter.

~~7.97.8~~ The uncertain cost categories, together with their associated PCFM Variable Values, are shown in Table 7.1. Under the Annual Iteration Process, allowed expenditure levels for uncertain cost activities represented by PCFM Variable 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.

**Table 7.1 – Uncertain cost categories**

Uncertain cost category	PCFM Variable Value name	<del>License Charge</del> <del>Restriction Condition</del>
High Value Project Costs	UCHVP	3F
Enhanced Physical Site Security Costs	UCEPS	3F
Specified Street Works Costs	UCSSW	3F
Rail Electrification Costs	UCRE	3F
Link Box Costs	UCLB	3F <del>—different provisions apply to LPN, SPN and EPN to the other licensees</del>
<del>Shetland Uncertain Energy Costs</del>	<del>UCSIC</del>	<del>3F—SSEH only</del>
<del>Shetland Competitive Process Costs</del>	<del>UCPC</del>	<del>3F—SSEH only</del>
<del>Subsea Cables Costs</del>	<del>UCSC</del>	<del>3F—SSEH only</del>

~~7.107.9~~ PCFM Variable Values relating to uncertain cost categories are stated in 2012/13 prices, consistent with the price base used in the ED1 Price Control Financial Model (PCFM) and the values for the term MOD. The allocation of allowed expenditure for uncertain cost categories into the Totex subdivisions 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.

~~7.117.10~~ CRC 3F provides for:

- proposals for revisions to levels of allowed expenditure (relevant adjustments), but only during application windows specified in CRC 3F;
- the determination of relevant adjustments by the Authority; and



- the deeming of relevant adjustments in circumstances specified in CRC 3F, in respect of each uncertain cost activity.

~~7.127.11~~ The application windows during which the licensee can propose relevant adjustments run from:

- ~~(a) 1 May 2016 to 31 May 2016 or such later date as the Authority may direct in respect of Subsea Cables Costs (applicable to SSEH only);~~
- ~~(b) 1 May 2017 to 31 May 2017 in respect of:~~
  - ~~▪ Shetland Uncertain Energy Costs (applicable to SSEH only); and~~
  - ~~▪ Shetland Competitive Process Costs (applicable to SSEH only);~~
- (ea) 1 July 2017 to 31 July 2017 in respect of Link Box Costs; and
- (eb) 1 May 2019 to 31 May 2019 in respect of all other uncertain cost categories.

~~7.13 This paragraph is applicable to LPN, SPN and EPN only. In addition CRC 3F provides for the Authority to propose and determine relevant adjustments in relation to Link Box Costs during a notice window that runs from 1 July 2017 to 31 July 2017.~~

~~7.14 This paragraph is applicable to SSEH only. CRC 3F also provides for the Authority to propose and determine relevant adjustments in relation to Shetland Uncertain Energy Costs and Shetland Competitive process Costs during a notice window that runs from 1 December 2017 to 31 December 2017.~~

~~7.157.12~~ CRC 3F and this chapter set out the basis for:

- (a) the proposal of relevant adjustments by the licensee and the Authority;
- (b) the determination of changes to allowed expenditure levels for the licensee with respect to relevant adjustments; and
- (b) the determination and direction of revised PCFM Variable Values to give effect to determinations referred to in subparagraph (b).

~~7.167.13~~ CRC 3F also provides for the Authority to propose relevant adjustments in relation to High Value Project Costs during a notice window that runs from 1 December 2023 to 31 December 2023. This is after the end of the Price Control Period and any determination of changes to allowed expenditure levels for High Value Project Costs 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*

~~7.177.14~~ The Authority will determine the 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 relevant application window referred to in paragraph ~~7.117.12~~, ~~unless the timetable is extended by the Authority in the circumstances and to the extent prescribed in as that may have been extended by the operation of~~ CRC 3F. The determination of relevant adjustments will be made

in accordance with the methodologies set out in sections 2 to ~~96~~, as applicable, of this chapter.

~~7.187.15~~ 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 concerned, and the proposal has not been withdrawn, then the relevant adjustment will be deemed to have been made.

~~7.19~~ ~~— This paragraph is applicable to SSEH only. The Authority will determine the relevant adjustments to levels of allowed expenditure on Shetland Uncertain Energy Costs and Shetland Competitive Process Costs, with respect to proposals it has made, after carrying out the consultation referred to in CRC 3F and having had regard to comments duly received in response to that consultation.~~

~~7.207.16~~ 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**

~~7.217.17~~ CRC 3F states that a proposed relevant adjustment to the level of allowed expenditure on an uncertain cost activity must:

- be based on information about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when the licensee's Opening Base Revenue Allowance was derived;
- take account of any relevant adjustments previously determined under CRC 3F;
- ~~for all uncertain cost activities other than High Value Projects,~~ constitute a material amount as specified for the licensee in Appendix ~~1~~, 2, 3, 4, ~~or 5, 6 or 7~~ (as the case may be) of CRC 3F;
- ~~for High Value Projects, pass the tests set out in Appendix 1 of CRC 3F;~~
- relate to costs incurred or expected to be incurred after 1 April 2015; and
- constitute an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of the licence.

~~7.227.18~~ 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.

~~7.237.19~~ 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.

## **Section 2 – Methodology for determining relevant adjustments in respect of High Value Project Costs**

### **The uncertainty mechanism for High Value Project Costs**

**7.247.20** For the purposes of CRC 3F and this chapter, the term High Value Project Costs means a scheme of works and the associated costs incurred, or expected to be incurred, by the licensee on any investment project with respect to its Distribution System that is reasonably forecast to cost the licensee £25 million or more (in 2012/13 prices) during the Price Control Period, and for which clear outputs, a needs case, and a statement of costs have been provided and in respect of which there is no other mechanism for the adjustment of allowed expenditure levels during the Price Control Period.

**7.257.21** ~~Some-Where~~ High Value Project Costs were taken into account in the calculation of the licensee's Opening Base Revenue Allowances, ~~t.~~ 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 are taken into account in assessing whether the 'tests for proposed relevant adjustments' (see paragraphs **7.227.26** and **7.237.27**) have been met.
- (ii) The Authority will review the licensee's achievement of outputs associated with High Value Project Costs when determining any relevant adjustment proposed by the licensee under CRC 3F.

#### *Tests for proposed relevant adjustments*

**7.267.22** Paragraph 3F.8(d) of CRC 3F specifies that a relevant adjustment in respect of High Value Project Costs may only be proposed (by the licensee or by the Authority) if two tests are met. The tests are detailed in Appendix 1 of CRC 3F.

**7.277.23** If the tests referred to in paragraph **7.227.26** are ~~are~~ not met, ~~then~~ any relevant adjustment proposal will be rejected. In that case, then as specified in chapter 3 of the Authority's 'Strategy decision for the RIIO-ED1 electricity distribution price control – Uncertainty mechanisms'<sup>24</sup>, the costs will be subject to the Totex Incentive Mechanism, and will not otherwise be logged up for future reimbursement.

#### **Determination of a relevant adjustment proposed by the licensee**

**7.287.24** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of High Value Project 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 **7.11**. If the Notice has been received before 1 May 2019, the Authority

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<sup>24</sup> <https://www.ofgem.gov.uk/ofgem-publications/47070/riioed1decuncertaintymechanisms.pdf>

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. costs incurred, or expected to be incurred, are reasonably forecast to cost the licensee £25 million or more;
  - b. each of the requirements set out in paragraphs 3F.8 and 3F.9 of CRC 3F ~~have has~~ been met (except for the requirement in respect of the tests referred to in paragraph 3F.8(d) of CRC 3F – see step (iii));
  - 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 check whether ~~the~~ the tests specified in paragraph 3F.8(d) of CRC 3F have been met.
- (iv) 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 give Notice of that requirement to the licensee as specified in paragraph 3F.13 of CRC 3F ~~as soon as reasonably practicable within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F and will allow such time for provision of that information~~ as appropriate, taking 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.12 of CRC 3F; and~~
  - c. ~~the need to consult the licensee on its proposed determination.~~
- It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.
- (v) The Authority will consider whether the outputs associated with the High Value Project Costs 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.297.25** A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of High Value Project 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 Regulatory Years.

**7.307.26** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of High Value Project Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.317.27** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCHVP values under section ~~10-7~~ of this chapter.

### **Section 3 – Methodology for determining relevant adjustments in respect of Enhanced Physical Site Security Costs**

#### **The uncertainty mechanism for Enhanced Physical Site Security Costs**

**7.327.28** The term Enhanced Physical Site Security Costs means costs incurred, or expected to be incurred, by the licensee for the purposes of implementing any formal recommendation or requirement of the Secretary of State to enhance the physical security of any of the sites that form part of the licensee's Distribution System as may be further clarified in the Regulatory instructions and Guidance (RIGs). This definition is set out in CRC 3F.

**7.337.29** ~~Requirements~~ Where requirements for Enhanced Physical Site Security related to some sites were taken into account in the calculation of the licensee's Opening Base Revenue Allowances, ~~the~~ the uncertainty mechanism only provides for adjustments to the licensee's allowed expenditure in the Price Control Period in respect of sites not included as part of ex ante allowances.

#### **Determination of a relevant adjustment proposed by the licensee**

**7.347.30** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security 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 7.11. 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.8 and 3F.9 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 give Notice of that requirement to the licensee, as specified in paragraph CRC 3F.13, within 10 working days of receipt of a proposal under paragraph CRC 3F.8. ~~as soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking 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.12 of CRC 3F; and~~
  - c. ~~the need to consult the licensee on its proposed determination.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- ~~(iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs **Error! Reference**~~

~~source not found.~~ to ~~Error! Reference source not found.~~. If it has not, the proposed relevant adjustment will be rejected.

- (iv) Having carried out steps (i) to (iii) 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.

If the Authority decides to reject the licensee’s proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vi) 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.

**7.357.31** A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Enhanced Physical Site Security 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 Regulatory Years.

**7.367.32** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.377.33** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCEPS values under section ~~10-7~~ of this chapter.

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

### The uncertainty mechanism for Specified Street Works Costs

**7.387.34** 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 lane rental scheme or equivalent and comprise:

- (a) permit fee costs, or equivalent;
- (b) lane rental costs, or equivalent;
- ~~(c) one-off set up costs;~~
- (c) ~~additional~~ administrative costs arising from the introduction of permit schemes or equivalent and lane rental schemes or equivalent; and
- (d) additional costs arising from the introduction of permit conditions or equivalent,

all as further clarified in the RIGs. ~~permit fee costs;~~

~~(b) one-off set up costs;~~

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

~~(d) additional costs arising from the introduction of permit conditions; and~~

~~(e) lane rental costs;~~

~~as further clarified in the RIGs. This definition is set out in CRC 3F.~~

~~7.35 Specified Street Work Costs are only associated with a new permit or lane rental scheme (or Scottish equivalent). These are ones which were not operational by 1 July 2013 or where the scheme was implemented by this date but the DNO did not have 12 months of cost data relating to the scheme. Only the costs of these schemes will be considered as part of the reopener mechanism.~~

~~7.397.36~~ 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*

~~7.407.37~~ 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 specified in the table in Appendix 3 to CRC 3F.

~~7.417.38~~ 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.

~~7.427.39~~ If the materiality threshold is not passed then, as specified in chapter 3 of the Authority's 'Strategy decision for the RIIO-ED1 electricity distribution price control – Uncertainty mechanisms'<sup>25</sup>, the costs will be subject to the Totex Incentive Mechanism, and will not otherwise be logged up for future reimbursement.

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<sup>25</sup> <https://www.ofgem.gov.uk/ofgem-publications/47070/riioed1decuncertaintymechanisms.pdf>



## Determination of a relevant adjustment proposed by the licensee

**7.437.40** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Specified Street Works Costs, it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

### Determination steps

- relevant
- (i) The Authority will check whether the Notice has been received during the application window referred to in paragraph 7.11. 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-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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
    - b. the licensee has provided, 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 give Notice of that requirement to the licensee as ~~soon as reasonably practicable and will allow such time for provision of that information as appropriately takes account of: specified in paragraph 3F.13 of CRC 3F within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F.~~
    - 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.12 of CRC 3F; and~~
    - c. ~~the need to consult the licensee on its proposed determination.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.
  - (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs 7.37 to 7.39. If it has not, the proposed relevant adjustment will be rejected.
  - (v) If it has passed the overall materiality threshold in accordance with paragraphs 7.37-40 to 7.39-42, the proposed relevant adjustment will be considered by the Authority.

- (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 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.

If the Authority decides to reject the licensee’s proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.447.41** 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 Regulatory Years.

**7.457.42** 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 the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.467.43** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSSW values under section ~~10~~7 of this chapter.

## Section 5 – Methodology for determining relevant adjustments in respect of Rail Electrification Costs

### The uncertainty mechanism for Rail Electrification Costs

**7.477.44** The term Rail Electrification Costs means costs incurred, or expected to be incurred, by the licensee in respect of the diversion of electric lines or electrical plant to facilitate rail electrification projects, as further clarified in the RIGs. The definition is set out in CRC 3F.

**7.487.45** 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*

**7.497.46** An overall materiality threshold applies in respect of relevant adjustments for Rail Electrification Costs. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 4 to CRC 3F.

**7.507.47** 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**

**7.517.48** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Rail Electrification 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 7.11. 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~~ 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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - b. the costs incurred or expected to be incurred fall within the definition of Rail Electrification Costs and have been or will be incurred during the Price Control Period;
  - c. the rail electrification projects to which the costs relate have been approved for funding by the Secretary of State for Transport;
  - d. the costs are not recoverable from a third party; and
  - e. 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 give Notice of that requirement ~~to the licensee as soon as reasonably practicable and will allow such time for provision of that information as appropriately takes account of as specified in paragraph 3F.13 of CRC 3F within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F.~~

- ~~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.12 of CRC 3F; and~~
- ~~c. the need to consult the licensee on its proposed determination.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph 7.46. If it has not, the proposed relevant adjustment will be rejected.
- (v) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it has carried out or commissioned.
- (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 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.

If the Authority decides to reject the licensee’s proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

7.527.49 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Rail Electrification 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 Regulatory Years.

7.537.50 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Rail Electrification Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19 of CRC 3F stipulates that the adjustments will be deemed to have been made.

7.547.51 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCRE values under section ~~10~~7 of this chapter.

## **Section 6 – Methodology for determining relevant adjustments in respect of Link Box Costs ~~—(applicable to ENWL, NPgN, NPgY, SPD, SPMW, SSEH and SSES)~~**

7.557.52 The term Link Box Costs means costs incurred, or expected to be incurred, by the licensee in efficiently managing the asset risk associated with Link Boxes, as may be further clarified in the RIGs. The definition is set out in CRC 3F.

7.567.53 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.

### *Materiality threshold*

7.577.54 An overall materiality threshold applies in respect of relevant adjustments for Link Box Costs. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 5 to CRC 3F.

7.587.55 If the materiality threshold is passed, because the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, 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.

### **The uncertainty mechanism for Link Box Costs**

7.597.56 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Link Box Costs, it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

- (i) The Authority will check whether the Notice has been received during the application window referred to in paragraph 7.11. If the Notice has been received before 1 July 2017, the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during July 2017. If the Notice has been received after 31 July 2017, the Authority will notify the licensee that the ~~notice~~ 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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - b. the costs incurred or expected to be incurred fall within the definition of Link Box Costs and have been or will be incurred during the Price Control Period;

- d. the costs are not recoverable from a third party; and
  - e. 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 give Notice of that requirement to the licensee ~~as soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.12 of CRC 3F; and~~
  - ~~c. the need to consult the licensee on its proposed determination as specified under paragraph 3F.13 of CRC 3F, within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph ~~7.46~~ 7.54. If it has not, the proposed relevant adjustment will be rejected.
- (v) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it has carried out or commissioned.
- (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 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

~~7.60~~7.57 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Link Box 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 Regulatory Years.

~~7.617.58~~ 7.617.58 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Link Box Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19 of CRC 3F stipulates that the adjustments will be deemed to have been made.

~~7.627.59~~ 7.627.59 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCLB values under section ~~10.7~~ of this chapter.

### **Section ~~10.7~~ – Determination, notification and direction of revised PCFM Variable Values for uncertain cost activities**

~~7.637.60~~ 7.637.60 CRC 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. Subject to paragraph 3F.13 in CRC 3F~~Subject to paragraph 7.X, iI, i~~ it also specifies that revised PCFM Variable Values relating to uncertain cost activities will be directed by the Authority by the following Regulatory Years:

- ~~• By 30 November 2016 (or such later date as directed by the Authority) for Subsea Cable Costs;~~
- ~~• By 30 November 2017 for Uncertain Energy Costs and Shetland Competitive Costs;~~
- By 30 November 2018 for Link Box Costs; and
- By 30 November 2019 for all other uncertain cost activities.

#### **Determination of revised PCFM Variable Values**

~~7.647.61~~ 7.647.61 On or before 31 October in the relevant direction deadline year, Ofgem will check to see whether any determinations of relevant adjustments have been made or have been deemed to have been made in respect of

- (a) High Value Project Costs;
- (b) Enhanced Physical Site Security Costs;
- (c) Specified Street Works Costs;
- (d) Rail Electrification Costs; and
- ~~(e) Shetland Uncertain Energy Costs;~~
- ~~(f) Shetland Competitive Process Costs;~~
- (ge) Link Box Costs; and
- ~~(h) Subsea Cables Cost;~~

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.

~~7.657.62~~ 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.

~~7.667.63~~ The PCFM Variable Values referred to in paragraph 7.62 are:

- (a) UCHVP values in respect of High Value Project Costs;
- (b) UCEPS values in respect of Enhanced Physical Site Security Costs;
- (c) UCSSW values in respect of Specified Street Works Costs;
- (d) UCRE values in respect of Rail Electrification Works Costs; and
- ~~(e) UCSIC values in respect of Shetland Uncertain Energy Costs;~~
- ~~(f) UCCPC values in respect of Shetland Competitive Process Costs;~~
- ~~(g) UCLB values in respect of Link Box Costs; and~~
- ~~(h) UCSS values in respect of Subsea Cables costs.~~

### Notification and direction of revised PCFM Variable Values

~~7.677.64~~ The Authority will give Notice of any revisions to UCHVP, UCEPS, UCSSW, UCRE, ~~UCSIC, UCCPC, and~~ UCLB and ~~UCSS~~ values that it proposes to direct by 15 November in the relevant direction deadline year, 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 CRC 3F, which cross refers to this chapter of this 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.

~~7.687.65~~ 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.

~~7.697.66~~ 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

~~7.707.67~~ If the procedures set out in CRC 3F and this chapter call for the Authority to direct revised PCFM Variable Values for one or more uncertain cost categories ~~by~~ within four months of the close of the relevant application window,



and the Authority does not make such a direction, then CRC 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

## 7. Uncertain costs allowed expenditure – financial adjustment methodology [applicable to LPN, SPN and EPN only]

### Section 1 - Overview

7.1 At the outset of the Price Control Period, levels of allowed expenditure for the following categories of uncertain costs were set on a provisional basis because of uncertainties about requirements:

- (a) High Value Project Costs;
- (b) Enhanced Physical Site Security Costs;
- (c) Specified Street Works Costs;
- (d) Rail Electrification Costs; and
- (e) Link Box Costs;

~~7.2 (f) Shetland Uncertain Energy Costs;~~

~~7.3 (g) Shetland Competitive Process Costs; and~~

~~7.4 (h) Subsea Cable Costs.~~

~~7.5 Category (e) set out in paragraph 7.1 does not apply to WMID, EMID, SWALES and SWEST. Categories (f), (g), and (h) are applicable to SSEH only.~~

~~7.67.2~~ The licensee's Opening Base Revenue Allowances were modelled using the provisional levels of allowed expenditure referred to in paragraph 7.1.

~~7.77.3~~ 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 Values associated with each uncertain cost activity should be revised.

~~7.87.4~~ At the start of the 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.

~~7.97.5~~ Opening levels of allowed expenditure for the licensee for the following cost categories are set out in appendices to CRC3F as shown below:

- High Value Projects Costs - Appendix 1; and
- Enhanced Physical Site Security Costs – Appendix 2;

~~7.10 Shetland Uncertain Energy Costs – Appendix 6; and~~

~~7.11 Shetland Competitive Process Costs – Appendix 7.~~

~~7.127.6~~ Opening levels of allowed expenditure for the licensee for the following cost categories are set at zero:

- Specified Street Works Costs;
- Rail Electrification Costs; and

- ~~Link Box Costs, and~~
- ~~Subsea Cable Costs.~~

~~7.137.7~~ The PCFM Variable Values for the uncertain cost categories can be revised so that they continue to match allowed expenditure levels following any relevant adjustments under the provisions of CRC 3F and this chapter.

~~7.147.8~~ The uncertain cost categories, together with their associated PCFM Variable Values, are shown in Table 7.1. Under the Annual Iteration Process, allowed expenditure levels for uncertain cost activities represented by PCFM Variable 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.

**Table 7.1 – Uncertain cost categories**

Uncertain cost category	PCFM Variable Value name	<del>Licence Charge Restriction</del> Condition
High Value Project Costs	UCHVP	3F
Enhanced Physical Site Security Costs	UCEPS	3F
Specified Street Works Costs	UCSSW	3F
Rail Electrification Costs	UCRE	3F
Link Box Costs	UCLB	3F <del>—different provisions apply to LPN, SPN and EPN to the other licensees</del>
<del>Shetland Uncertain Energy Costs</del>	<del>UCSFE</del>	<del>3F—SSEH only</del>
<del>Shetland Competitive Process Costs</del>	<del>UCCPC</del>	<del>3F—SSEH only</del>
<del>Subsea Cable Costs</del>	<del>UCSC</del>	<del>3F—SSEH only</del>

~~7.157.9~~ PCFM Variable Values relating to uncertain cost categories are stated in 2012/13 prices, consistent with the price base used in the ED1 Price Control Financial Model (PCFM) and the values for the term MOD. The allocation of allowed expenditure for uncertain cost categories into the Totex subdivisions 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.

~~7.167.10~~ CRC 3F provides for:

- proposals for revisions to levels of allowed expenditure (relevant adjustments), but only during application windows specified in CRC 3F;
- the determination of relevant adjustments by the Authority; and

- the deeming of relevant adjustments in circumstances specified in CRC 3F, in respect of each uncertain cost activity.

~~7.177.11~~ The application windows during which the licensee can propose relevant adjustments run from:

- ~~(a) 1 May 2016 to 31 May 2016 or such later date as the Authority may direct in respect of Subsea Cable Costs (applicable to SSEH only);~~
- ~~(b) 1 May 2017 to 31 May 2017 in respect of:  
Shetland Uncertain Energy Costs (applicable to SSEH only); and  
Shetland Competitive Process Costs (applicable to SSEH only);~~
- (ea) 1 July 2017 to 31 July 2017 in respect of Link Box Costs; and
- (eb) 1 May 2019 to 31 May 2019 in respect of all other uncertain cost categories.

~~7.187.12~~ ~~This paragraph is applicable to LPN, SPN and EPN only.~~ In addition CRC 3F provides for the Authority to propose and determine relevant adjustments in relation to Link Box Costs during a notice window that runs from 1 July 2017 to 31 July 2017.

~~7.19~~ ~~This paragraph is applicable to SSEH only. CRC 3F also provides for the Authority to propose and determine relevant adjustments in relation to Shetland Uncertain Energy Costs and Shetland Competitive process Costs during a notice window that runs from 1 December 2017 to 31 December 2017.~~

~~7.207.13~~ CRC 3F and this chapter set out the basis for:

- (a) the proposal of relevant adjustments by the licensee and the Authority;
- (b) the determination of changes to allowed expenditure levels for the licensee with respect to relevant adjustments; and
- (bc) the determination and direction of revised PCFM Variable Values to give effect to determinations referred to in subparagraph (b).

~~7.217.14~~ CRC 3F also provides for the Authority to propose relevant adjustments in relation to High Value Project Costs during a notice window that runs from 1 December 2023 to 31 December 2023. This is after the end of the Price Control Period and any determination of changes to allowed expenditure levels for High Value Project Costs 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*

~~7.227.15~~ The Authority will determine the 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 relevant application window referred to in paragraph ~~7.117.12~~, ~~unless the timetable is extended by the Authority in the circumstances and to the extent prescribed in CRC 3F as that may be extended by the operation of CRC 3F~~. The determination of relevant adjustments will be made in accordance with the methodologies set out in sections 2 to ~~96~~, as applicable, of this chapter.

7.237.16 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 concerned, and the proposal has not been withdrawn, then the relevant adjustment will be deemed to have been made.

~~7.24 This paragraph is applicable to SSEH only. The Authority will determine the relevant adjustments to levels of allowed expenditure on Shetland Uncertain Energy Costs and Shetland Competitive Process Costs, with respect to proposals it has made, after carrying out the consultation referred to in CRC 3F and having had regard to comments duly received in response to that consultation.~~

7.257.17 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**

7.267.18 CRC 3F states that a proposed relevant adjustment to the level of allowed expenditure on an uncertain cost activity must:

- be based on information about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when the licensee's Opening Base Revenue Allowance was derived;
- take account of any relevant adjustments previously determined under CRC 3F;
- ~~for all uncertain costs activities other than High Value Project Costs,~~ constitute a material amount as specified for the licensee in Appendix ~~1,~~ 2, 3, 4, ~~or 5, 6 or 7~~ (as the case may be) of CRC 3F;
- ~~for High Value Projects passes the tests set out in Appendix 1 of CRC 3F;~~
- relate to costs incurred or expected to be incurred after 1 April 2015; and
- constitute an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of the licence.

7.277.19 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.

7.287.20 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.

## **Section 2 – Methodology for determining relevant adjustments in respect of High Value Project Costs**

### **The uncertainty mechanism for High Value Project Costs**

**7.297.21** For the purposes of CRC 3F and this chapter, the term High Value Project Costs means a scheme of works and the associated costs incurred, or expected to be incurred, by the licensee on any investment project with respect to its Distribution System that is reasonably forecast to cost the licensee £25 million or more (in 2012/13 prices) during the Price Control Period, and for which clear outputs, a needs case, and a statement of costs have been provided and in respect of which there is no other mechanism for the adjustment of allowed expenditure levels during the Price Control Period.

**7.307.22** Some High Value Project Costs 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 are taken into account in assessing whether the 'tests for proposed relevant adjustments' (see paragraphs **7.227.22** and **7.277.23**) have been met.
- (ii) The Authority will review the licensee's achievement of outputs associated with High Value Project Costs when determining any relevant adjustment proposed by the licensee under CRC 3F.

#### *Tests for proposed relevant adjustments*

**7.317.23** Paragraph 3F.8(d) of CRC 3F specifies that a relevant adjustment in respect of High Value Project Costs may only be proposed (by the licensee or by the Authority) if two tests are met. The tests are detailed in Appendix 1 of CRC3F.

**7.327.24** If the tests referred to in paragraph **7.267.24** are ~~are~~ not met, then any relevant adjustment proposal will be rejected. In that case, then as specified in chapter 3 of the Authority's 'Strategy decision for the RIIO-ED1 electricity distribution price control – Uncertainty mechanisms'<sup>26</sup>, the costs will be subject to the Totex Incentive Mechanism, and will not otherwise be logged up for future reimbursement.

#### **Determination of a relevant adjustment proposed by the licensee**

**7.337.25** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of High Value Project 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 **7.12**. If the Notice has been received before 1 May 2019, the Authority will

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<sup>26</sup> <https://www.ofgem.gov.uk/ofgem-publications/47070/riioed1decuncertaintymechanisms.pdf>

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. costs incurred, or expected to be incurred, are reasonably forecast to cost the licensee £25 million or more;
  - b. each of the requirements set out in paragraphs 3F.8 and 3F.9-10 of CRC 3F have been met (except for the requirement in respect of the tests referred to in paragraph 3F.8(d) of CRC 3F – see step (iii));
  - 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 check whether, the tests specified in paragraph 3F.8(d) of CRC 3F have been met.
- (iv) 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 give Notice of that requirement to the licensee ~~as soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking account of as specified in paragraph 3F.13 of CRC 3F, within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F.~~
  - ~~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.12 of CRC 3F; and~~
  - ~~c. the need to consult the licensee on its proposed determination.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.
- (v) The Authority will consider whether the outputs associated with the High Value Project Costs 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.347.26** A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of High Value Project 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 Regulatory Years.

**7.357.27** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of High Value Project Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19-20 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.367.28** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCHVP values under section 10-7 of this chapter.

### **Section 3 – Methodology for determining relevant adjustments in respect of Enhanced Physical Site Security Costs**

#### **The uncertainty mechanism for Enhanced Physical Site Security Costs**

**7.377.29** The term Enhanced Physical Site Security Costs means costs incurred, or expected to be incurred, by the licensee for the purposes of implementing any formal recommendation or requirement of the Secretary of State to enhance the physical security of any of the sites that form part of the licensee's Distribution System as may be further clarified in the Regulatory instructions and Guidance (RIGs). This definition is set out in CRC 3F.

**7.387.30** Requirements for Enhanced Physical Site Security related to some sites were taken into account in the calculation of the licensee's Opening Base Revenue Allowances. The uncertainty mechanism only provides for adjustments to the licensee's allowed expenditure in the Price Control Period in respect of sites not included as part of ex ante allowances.

#### **Determination of a relevant adjustment proposed by the licensee**



**7.397.31** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security 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 **7.12**. 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.8 and 3F.109 of CRC 3F has been met (except for the requirement in respect of a material amount);
  - 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 give Notice of that requirement to the licensee ~~as soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking 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.12 of CRC 3F; and~~
  - c. ~~the need to consult the licensee on its proposed determination as specified in paragraph 3F.13 of CRC 3F, within 10 Working Days of receipt of a proposal under paragraph 3F.8 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) Having carried out steps (i) to (iii) 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (v) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (vi) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.407.32** A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Enhanced Physical Site Security 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 Regulatory Years.

**7.417.33** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.2019 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.427.34** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCEPS values under section 10-7 of this chapter.

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

### The uncertainty mechanism for Specified Street Works Costs

**7.437.35** 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 lane rental scheme or equivalent and comprise:

- (a) permit fee costs, or equivalent;
- (b) lane rental costs, or equivalent;
- (c) one-off set up costs;

- ~~(ed) additional administrative costs arising from the introduction of permit schemes or equivalent and lane rental schemes or equivalent;~~
- ~~(de) additional costs arising from the introduction of permit conditions or equivalent,  
as further clarified in the RI permit fee costs;~~
- ~~(b) one off set up costs;~~
- ~~(c) additional administrative costs arising from the introduction of permit schemes;~~
- ~~(d) additional costs arising from the introduction of permit conditions; and~~
- ~~(e) lane rental costs;~~

all as further clarified in the RIGs. This definition is set out in CRC 3F.

7.36 Specified Street Work Costs are only costs associated with a new permit or lane scheme (or Scottish equivalent). These are ones which were not operational by 1 July 2013 or where the scheme was implemented by this date but the DNO did not have 12 months of cost data relating to the scheme. Only the costs of these schemes will be considered as part of the reopener mechanism.

7.447.37 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*

7.457.38 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 specified in the table in Appendix 3 to CRC 3F.

7.467.39 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.

7.477.40 If the materiality threshold is not passed then, as specified in chapter 3 of the Authority's 'Strategy decision for the RIIO-ED1 electricity distribution price control – Uncertainty mechanisms'<sup>27</sup>, the costs will be subject to the Totex Incentive Mechanism, and will not otherwise be logged up for future reimbursement.

#### **Determination of a relevant adjustment proposed by the licensee**

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

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<sup>27</sup> <https://www.ofgem.gov.uk/ofgem-publications/47070/riioed1decuncertaintymechanisms.pdf>

*Determination steps*

- (i) The Authority will check whether the Notice has been received during the application window referred to in paragraph ~~7.12~~. 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.8 and 3F.109 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - 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 give Notice of that requirement to the licensee as ~~soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.12 of CRC 3F; and~~
  - ~~c. the need to consult the licensee on its proposed determination specified in in paragraph 3F.13 of CRC 3F, within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F.~~
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- It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.
- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs ~~7.39 to 7.40~~. If it has not, the proposed relevant adjustment will be rejected.
- (v) If it has passed the overall materiality threshold in accordance with paragraphs ~~7.39 to 7.40~~ ~~7.35 to 7.37~~, the proposed relevant adjustment will be considered by the Authority.
- (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 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.497.42** 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 Regulatory Years.

**7.507.43** 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 the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19-20 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.517.44** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSSW values under section 10-7 of this chapter.

## Section 5 – Methodology for determining relevant adjustments in respect of Rail Electrification Costs

### The uncertainty mechanism for Rail Electrification Costs

**7.527.45** The term Rail Electrification Costs means costs incurred, or expected to be incurred, by the licensee in respect of the diversion of electric lines or electrical plant to facilitate rail electrification projects, as further clarified in the RIGs. The definition is set out in CRC 3F.

**7.537.46** 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*

**7.547.47** An overall materiality threshold applies in respect of relevant adjustments for Rail Electrification Costs. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 4 to CRC 3F.

7.557.48 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**

7.567.49 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Rail Electrification 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 7.12. 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~~ 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.8 and 3F.~~9-10~~ of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - b. the costs incurred or expected to be incurred fall within the definition of Rail Electrification Costs and have been or will be incurred during the Price Control Period;
  - c. the rail electrification projects to which the costs relate have been approved for funding by the Secretary of State for Transport;
  - d. the costs are not recoverable from a third party; and
  - e. 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 give Notice of that requirement to the licensee as specified in paragraph 3F.13 of CRC 3F, within 10 working days of receipt of a proposal under paragraph 3F.8 of CRC 3F. as soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.12 of CRC 3F; and~~
  - ~~c. the need to consult the licensee on its proposed determination.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph ~~7.497.53~~. If it has not, the proposed relevant adjustment will be rejected.
- (vi) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it 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.

If the Authority decides to reject the licensee’s proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (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.

~~7.577.50~~ A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Rail Electrification 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 Regulatory Years.

~~7.587.51~~ If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Rail Electrification Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F. ~~19-20~~ of CRC 3F stipulates that the adjustments will be deemed to have been made.

~~7.52~~ The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCRE values under section ~~10-7~~ of this chapter.

## Section 6A – Methodology for determining relevant adjustments in respect of Link Box Costs ~~—(applicable to LPN, SPN and EPN only)~~

7.597.53 The term Link Box Costs means costs incurred, or expected to be incurred, by the licensee in efficiently managing the asset risk associated with Link Boxes, as may be further clarified in the RIGs. The definition is set out in CRC 3F

7.607.54 Link Box Costs for Regulatory Years 2015/16 and 2016/17 were taken into account in the calculation of the licensee's Opening Base Revenue Allowances. The uncertainty mechanism provides for the licensee to apply for adjustments to allowed expenditure for Link Box Costs in respect of Regulatory Years within the Price Control period from 2017/18 onwards. It also provides for the Authority to propose adjustments in respect of Link Box Costs for Regulatory Years 2015/16 and 2016/17.

### *Application/proposal windows*

7.617.55 The licensee~~s~~ and the Authority may only give Notice of a proposed relevant adjustment during an application window that opens on 1 July 2017 and closes on 31 July 2017.

### *Materiality threshold*

7.627.56 An overall materiality threshold applies in respect of relevant adjustments for Link Box Costs. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 5 to CRC 3F.

7.637.57 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.

### **The uncertainty mechanism for Link Box Costs**

7.647.58 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Link Box Costs it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

- (i) The Authority will check whether the Notice has been received during the application window referred to in paragraph 7.117.12.  
       If the Notice has been received before 1 July 2017, the Authority  
       will notify the licensee that the Notice has been submitted too early  
       and should be resubmitted during July 2017. If the Notice has  
       been received after 31 July 2017, 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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - b. the costs incurred or expected to be incurred fall within the definition of Link Box Costs and have been or will be incurred during the Price Control Period;
  - c. the costs are not recoverable from a third party; and
  - d. 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 give Notice of that requirement to the licensee as soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.13 of CRC 3F; and
  - c. the need to consult the licensee on its proposed determination.

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph [7.467.53](#). If it has not, the proposed relevant adjustment will be rejected.
- (v) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it has carried out or commissioned.
- (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 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) 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.

**7.657.59** A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Link Box 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 Regulatory Years.

**7.667.60** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Link Box Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.20 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.677.61** If the Authority gives Notice within the application window to the licensee that it proposes to direct adjustments to UCLB values for Regulatory Years 2015/16 and 2016/17 it will consider any responses duly made by the licensee before issuing a determination in respect of those values. Its determination can confirm, amend or reject the proposal. The Authority may not determine negative adjustments to such values greater than those specified in Table 2 to Appendix 5.

**7.687.62** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCLB values under section 10 of this chapter.

## **Section ~~10-7~~ – Determination, notification and direction of revised PCFM Variable Values for uncertain cost activities**

**7.697.63** CRC 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. Subject to paragraph 3F.14 of CRC 3F, ~~it~~ it also specifies that revised PCFM Variable Values relating to uncertain cost activities will be directed by the Authority by the following Regulatory Years:

- ~~• By 30 November 2016 (or such later date as directed by the Authority) for Subsea Cable Costs;~~
- ~~• By 30 November 2017 for Uncertain Energy Costs and Shetland Competitive Costs;~~
- By 30 November 2018 for Link Box Costs; and

- By 30 November 2019 for all other uncertain cost activities.

### Determination of revised PCFM Variable Values

~~7.707.64~~ On or before 31 October in the relevant direction deadline year, Ofgem will check to see whether any determinations of relevant adjustments have been made or have been deemed to have been made in respect of

- (a) High Value Project Costs;
- (b) Enhanced Physical Site Security Costs;
- (c) Specified Street Works Costs;
- (d) Rail Electrification Costs; and
- ~~(e) Shetland Uncertain Energy Costs;~~
- ~~(f) Shetland Competitive Process Costs;~~
- ~~(g)~~ Link Box Costs; and
- ~~(h) Subsea Cable 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.

~~7.717.65~~ 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.

~~7.727.66~~ The PCFM Variable Values referred to in paragraph ~~7.627.107~~ are:

- (a) UCHVP values in respect of High Value Project Costs;
- (b) UCEPS values in respect of Enhanced Physical Site Security Costs;
- (c) UCSSW values in respect of Specified Street Works Costs;
- (d) UCRE values in respect of Rail Electrification Works Costs;
- ~~(e) UCSFE values in respect of Shetland Uncertain Energy Costs;~~
- ~~(f) UCCPC values in respect of Shetland Competitive Process Costs;~~
- ~~(g)~~ UCLB values in respect of Link Box Costs; and
- ~~(h) UCSC values in respect of Subsea Cables costs.~~

### Notification and direction of revised PCFM Variable Values

~~7.737.67~~ The Authority will give Notice of any revisions to UCHVP, UCEPS, UCSSW, UCRE, ~~UCSFE, UCCPC~~ and, UCLB and ~~UCSC~~ values that it proposes to direct by 15 November in the relevant direction deadline year, 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 CRC 3F, which cross refers to this chapter of this 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.

7.747.68 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.

7.757.69 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**

7.767.70 If the procedures set out in CRC 3F and this chapter call for the Authority to direct revised PCFM Variable Values for one or more uncertain cost categories ~~by~~ within four months of the close of the relevant application window, and the Authority does not make such a direction, then CRC 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

## 7. Uncertain costs allowed expenditure – financial adjustment methodology [applicable to SSEH only]

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### Section 1 - Overview

7.1 At the outset of the Price Control Period, levels of allowed expenditure for the following categories of uncertain costs were set on a provisional basis because of uncertainties about requirements:

- (a) High Value Project Costs;
- (b) Enhanced Physical Site Security Costs;
- (c) Specified Street Works Costs;
- (d) Rail Electrification Costs;
- (e) Link Box Costs;
- (f) Shetland Uncertain Energy Costs;
- (g) Shetland Competitive Process Costs; and
- (h) Subsea Cable Costs.

~~7.2 Category (e) set out in paragraph 7.1 does not apply to WMID, EMID, SWALES and SWEST. Categories (f), (g), and (h) are applicable to SSEH only.~~

~~7.37.2~~ The licensee's Opening Base Revenue Allowances were modelled using the provisional levels of allowed expenditure referred to in paragraph 7.1.

~~7.47.3~~ 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 Values associated with each uncertain cost activity should be revised.

~~7.57.4~~ At the start of the 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.

~~7.67.5~~ Opening levels of allowed expenditure for the licensee for the following cost categories are set out in appendices to CRC3F as shown below:

- High Value Projects Costs - Appendix 1;
- Enhanced Physical Site Security Costs – Appendix 2;
- Shetland Uncertain Energy Costs – Appendix 6; and
- Shetland Competitive Process Costs – Appendix 7.

~~7.77.6~~ Opening levels of allowed expenditure for the licensee for the following cost categories are set at zero:

- Specified Street Works Costs;
- Rail Electrification Costs;

- Link Box Costs; and
- Subsea Cable Costs.

**7.87.7** The PCFM Variable Values for the uncertain cost categories can be revised so that they continue to match allowed expenditure levels following any relevant adjustments under the provisions of CRC 3F and this chapter.

**7.97.8** The uncertain cost categories, together with their associated PCFM Variable Values, are shown in Table 7.1. Under the Annual Iteration Process, allowed expenditure levels for uncertain cost activities represented by PCFM Variable 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.

**Table 7.1 – Uncertain cost categories**

<b>Uncertain cost category</b>	<b>PCFM Variable Value name</b>	<b><del>License Charge</del> Restriction Condition</b>
High Value Project Costs	UCHVP	3F
Enhanced Physical Site Security Costs	UCEPS	3F
Specified Street Works Costs	UCSSW	3F
Rail Electrification Costs	UCRE	3F
Link Box Costs	UCLB	<del>3F—different provisions apply to LPN, SPN and EPN to the other licensees</del>
Shetland Uncertain Energy Costs	UCSFE	<del>3F—SSEH only</del>
Shetland Competitive Process Costs	UCCPC	<del>3F—SSEH only</del>
Subsea Cable Costs	UCSC	<del>3FF—SSEH only</del>

**7.107.9** PCFM Variable Values relating to uncertain cost categories are stated in 2012/13 prices, consistent with the price base used in the ED1 Price Control Financial Model (PCFM) and the values for the term MOD. The allocation of allowed expenditure for uncertain cost categories into the Totex subdivisions 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.

**7.117.10** CRC 3F provides for:

- proposals for revisions to levels of allowed expenditure (relevant adjustments), but only during application windows specified in CRC 3F;
- the determination of relevant adjustments by the Authority; and

- the deeming of relevant adjustments in circumstances specified in CRC 3F, in respect of each uncertain cost activity.

~~7.127.11~~ The application windows during which the licensee can propose relevant adjustments run from:

- (a) 1 May 2016 to 31 May 2016 or such later date as the Authority may direct in respect of Subsea Cable Costs (applicable to SSEH only);
- (b) 1 May 2017 to 31 May 2017 in respect of:
  - Shetland Uncertain Energy Costs (applicable to SSEH only); and
  - Shetland Competitive Process Costs (applicable to SSEH only);
- (c) 1 July 2017 to 31 July 2017 in respect of Link Box Costs; and
- (d) 1 May 2019 to 31 May 2019 in respect of all other uncertain cost categories.

~~7.13~~ ~~This paragraph is applicable to LPN, SPN and EPN only. In addition CRC 3F provides for the Authority to propose and determine relevant adjustments in relation to Link Box Costs during a notice window that runs from 1 July 2017 to 31 July 2017.~~

~~7.147.12~~ ~~This paragraph is applicable to SSEH only.~~ CRC 3F also provides for the Authority to propose and determine relevant adjustments in relation to Shetland Uncertain Energy Costs and Shetland Competitive process Costs during a notice window that runs from 1 December 2017 to 31 December 2017.

~~7.157.13~~ CRC 3F and this chapter set out the basis for:

- (a) the proposal of relevant adjustments by the licensee and the Authority;
- (b) the determination of changes to allowed expenditure levels for the licensee with respect to relevant adjustments; and
- (b) the determination and direction of revised PCFM Variable Values to give effect to determinations referred to in subparagraph (b).

~~7.167.14~~ CRC 3F also provides for the Authority to propose relevant adjustments in relation to High Value Project Costs during a notice window that runs from 1 December 2023 to 31 December 2023. This is after the end of the Price Control Period and any determination of changes to allowed expenditure levels for High Value Project Costs 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*

~~7.177.15~~ The Authority will determine the 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 relevant application window referred to in paragraph ~~7.117.12~~, ~~unless the timetable is extended by the Authority in the circumstances and to the extent prescribed in CRC 3F, as that may be extended by the operation of CRC 3F.~~ The determination of relevant

adjustments will be made in accordance with the methodologies set out in sections 2 to 9, as applicable, of this chapter.

**7.187.16** 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 concerned, and the proposal has not been withdrawn, then the relevant adjustment will be deemed to have been made.

**7.197.17** This paragraph is applicable to SSEH only. The Authority will determine the relevant adjustments to levels of allowed expenditure on Shetland Uncertain Energy Costs and Shetland Competitive Process Costs, with respect to proposals it has made, after carrying out the consultation referred to in CRC 3F and having had regard to comments duly received in response to that consultation.

**7.207.18** 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**

**7.217.19** CRC 3F states that a proposed relevant adjustment to the level of allowed expenditure on an uncertain cost activity must:

- be based on information about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when the licensee's Opening Base Revenue Allowance was derived;
- take account of any relevant adjustments previously determined under CRC 3F;
- **for all uncertain cost activities other than High Value Project Costs,** constitute a material amount as specified for the licensee in Appendix 2, 3, 4, 5, 6 or 7 (as the case may be) of CRC 3F;
- **for High Value Projects passes the tests set out in Appendix 1 of CRC 3F;**
- relate to costs incurred or expected to be incurred after 1 April 2015; and
- constitute an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of the licence.

**7.227.20** 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.

**7.237.21** 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.

## **Section 2 – Methodology for determining relevant adjustments in respect of High Value Project Costs**

### **The uncertainty mechanism for High Value Project Costs**



**7.247.22** For the purposes of CRC 3F and this chapter, the term High Value Project Costs means a scheme of works and the associated costs incurred, or expected to be incurred, by the licensee on any investment project with respect to its Distribution System that is reasonably forecast to cost the licensee £25 million or more (in 2012/13 prices) during the Price Control Period, and for which clear outputs, a needs case, and a statement of costs have been provided and in respect of which there is no other mechanism for the adjustment of allowed expenditure levels during the Price Control Period.

**7.257.23** Some High Value Project Costs 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 are taken into account in assessing whether the 'tests for proposed relevant adjustments' (see paragraphs **7.227-26** and **7.237-27**) have been met.
- (ii) The Authority will review the licensee's achievement of outputs associated with High Value Project Costs when determining any relevant adjustment proposed by the licensee under CRC 3F.

#### *Tests for proposed relevant adjustments*

**7.267.24** Paragraph 3F.8(d) of CRC 3F specifies that a relevant adjustment in respect of High Value Project Costs may only be proposed (by the licensee or by the Authority) if two tests are met. The tests are detailed in Appendix 1 of CRC3F.

**7.277.25** If the tests referred to in paragraph **7.227-26** are ~~are~~ not met, then any relevant adjustment proposal will be rejected. In that case, then as specified in chapter 3 of the Authority's 'Strategy decision for the RIIO-ED1 electricity distribution price control – Uncertainty mechanisms'<sup>28</sup>, the costs will be subject to the Totex Incentive Mechanism, and will not otherwise be logged up for future reimbursement.

#### **Determination of a relevant adjustment proposed by the licensee**

**7.287.26** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of High Value Project 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 **7.117-12**.

If the

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<sup>28</sup> <https://www.ofgem.gov.uk/ofgem-publications/47070/riioed1decuncertaintymechanisms.pdf>

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. costs incurred, or expected to be incurred, are reasonably forecast to cost the licensee £25 million or more;
  - b. each of the requirements set out in paragraphs 3F.8 and 3F.9 of CRC 3F have been met (except for the requirement in respect of the tests referred to in paragraph 3F.8(d) of CRC 3F – see step (iii));
  - 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 check whether, the tests specified in paragraph 3F.8(d) of CRC 3F have been met.
- (iv) 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 give Notice of that requirement to the licensee ~~as soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking 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.12 of CRC 3F; and~~
  - ~~c. the need to consult the licensee on its proposed determination as specified in paragraph 3F.14 of CRC 3F, within 10 working days of receipt of a proposal under paragraph 3F.10 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (v) The Authority will consider whether the outputs associated with the High Value Project Costs 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.297.27** A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of High Value Project 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 Regulatory Years.

**7.307.28** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of High Value Project Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.2019 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.317.29** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCHVP values under section 10 of this chapter.

### **Section 3 – Methodology for determining relevant adjustments in respect of Enhanced Physical Site Security Costs**

#### **The uncertainty mechanism for Enhanced Physical Site Security Costs**

**7.327.30** The term Enhanced Physical Site Security Costs means costs incurred, or expected to be incurred, by the licensee for the purposes of implementing any formal recommendation or requirement of the Secretary of State to enhance the physical security of any of the sites that form part of the licensee's Distribution System as may be further clarified in the Regulatory instructions and Guidance (RIGs). This definition is set out in CRC 3F.

**7.337.31** Requirements for Enhanced Physical Site Security related to some sites were taken into account in the calculation of the licensee's Opening Base Revenue Allowances. The uncertainty mechanism only provides for adjustments to the licensee's allowed expenditure in the Price Control Period in respect of sites not included as part of ex ante allowances.

#### **Determination of a relevant adjustment proposed by the licensee**

**7.347.32** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security 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 7.11. 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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount);
  - 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 give Notice of that requirement to the licensee as ~~soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking 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.12 of CRC 3F; and~~
  - c. ~~the need to consult the licensee on its proposed determination specified in paragraph 3F.14 of CRC 3F, within 10 working days of a proposal under paragraph 3F.10 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) Having carried out steps (i) to (iii) 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (v) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (vi) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.357.33** A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Enhanced Physical Site Security 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 Regulatory Years.

**7.367.34** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Enhanced Physical Site Security Costs and does not make an relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19-20 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.377.35** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCEPS values under section 10 of this chapter.

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

### The uncertainty mechanism for Specified Street Works Costs

**7.387.36** 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 lane rental scheme or equivalent and comprise:

- (a) permit fee costs, or equivalent;
- (b) lane rental costs, or equivalent;
- (c) one-off set up costs;

- (c) ~~additional~~ administrative costs arising from the introduction of permit schemes or equivalent and lane rental schemes or equivalent; and
- (d) additional costs arising from the introduction of permit conditions or equivalent;  
~~as further clarified in the RI permit fee costs;~~
- ~~(b) one off set up costs;~~
- ~~(c) additional administrative costs arising from the introduction of permit schemes;~~
- ~~(d) additional costs arising from the introduction of permit conditions; and~~
- ~~(e) lane rental costs;~~

as further clarified in the RIGs. This definition is set out in CRC 3F.

7.37 Specified Street Work Costs are only costs associated with a new permit or lane rental scheme (or Scottish equivalent). These are ones which were not operational by 1 July 2013 or where the scheme was implemented by this date but the DNO did not have 12 months of cost data relating to the scheme. Only the costs of these schemes will be considered as part of the reopener mechanism.

7.397.38 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*

7.407.39 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 specified in the table in Appendix 3 to CRC 3F.

7.417.40 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.

7.427.41 If the materiality threshold is not passed then, as specified in chapter 3 of the Authority’s ‘Strategy decision for the RIIO-ED1 electricity distribution price control – Uncertainty mechanisms’<sup>29</sup>, the costs will be subject to the Totex Incentive Mechanism, and will not otherwise be logged up for future reimbursement.

**Determination of a relevant adjustment proposed by the licensee**

7.437.42 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Specified Street Works Costs it will take the steps

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<sup>29</sup> <https://www.ofgem.gov.uk/ofgem-publications/47070/riioed1decuncertaintymechanisms.pdf>

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 ~~7.117.12~~. 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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - 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 give Notice of that requirement to the licensee ~~as soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.12 of CRC 3F; and~~
  - ~~c. the need to consult the licensee on its proposed determination as specified in paragraph 3F.14 of CRC 3F, within 10 working days of receipt of a proposal under 3F.10 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.
- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs ~~7.397.44~~ to ~~7.417.46~~. If it has not, the proposed relevant adjustment will be rejected.
- (v) If it has passed the overall materiality threshold in accordance with paragraphs ~~7.377.44~~ to ~~7.397.46~~, the proposed relevant adjustment will be considered by the Authority.
- (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 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

**7.447.43** 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 Regulatory Years.

**7.457.44** 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 the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.19-20 of CRC 3F stipulates that the adjustments will be deemed to have been made.

**7.467.45** The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSSW values under section 10 of this chapter.

## Section 5 – Methodology for determining relevant adjustments in respect of Rail Electrification Costs

### The uncertainty mechanism for Rail Electrification Costs

**7.477.46** The term Rail Electrification Costs means costs incurred, or expected to be incurred, by the licensee in respect of the diversion of electric lines or electrical plant to facilitate rail electrification projects, as further clarified in the RIGs. The definition is set out in CRC 3F.

**7.487.47** 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*



~~7.497.48~~ An overall materiality threshold applies in respect of relevant adjustments for Rail Electrification Costs. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 4 to CRC 3F.

~~7.507.49~~ 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**

~~7.517.50~~ If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Rail Electrification 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 ~~7.117.12~~. 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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - b. the costs incurred or expected to be incurred fall within the definition of Rail Electrification Costs and have been or will be incurred during the Price Control Period;
  - c. the rail electrification projects to which the costs relate have been approved for funding by the Secretary of State for Transport;
  - d. the costs are not recoverable from a third party; and
  - e. 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 give Notice of that requirement to the licensee ~~as soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.12 of CRC 3F; and~~

~~c. the need to consult the licensee on its proposed determination as specified under paragraph 3F.14 of CRC 3F, within 10 working days of a proposal under paragraph 3F.10 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph ~~7.567.53~~. -If it has not, the proposed relevant adjustment will be rejected.
- (vi) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it 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.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (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.

~~7.527.51~~ A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Rail Electrification 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 Regulatory Years.

~~7.537.52~~ If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Rail Electrification Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F. ~~2019~~ of CRC 3F stipulates that the adjustments will be deemed to have been made.

~~7.547.53~~ The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCRE values under section 10 of this chapter.

## Section 6 – Methodology for determining relevant adjustments in respect of Link Box Costs ~~—(applicable to ENWL, NPgN, NPgY, SPD, SPMW, SSEH and SSES)~~

7.557.54 The term Link Box Costs means costs incurred, or expected to be incurred, by the licensee in efficiently managing the asset risk associated with Link Boxes, as may be further clarified in the RIGs. The definition is set out in CRC 3F.

7.567.55 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.

### *Materiality threshold*

7.577.56 An overall materiality threshold applies in respect of relevant adjustments for Link Box Costs. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 5 to CRC 3F.

7.587.57 If the materiality threshold is passed, because the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, 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.

### **The uncertainty mechanism for Link Box Costs**

7.597.58 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Link Box Costs it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

- (i) The Authority will check whether the Notice has been received during the application window referred to in paragraph 7.117.12.  
If the Notice has been received before 1 July 2017, the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during July 2017. If the Notice has been received after 31 July 2017, 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.8 and 3F.9 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv));
  - b. the costs incurred or expected to be incurred fall within the definition of Link Box Costs and have been or will be incurred during the Price Control Period;
  - d. the costs are not recoverable from a third party; and

- e. 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 give Notice of that requirement to the licensee as ~~soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.12 of CRC 3F; and~~
  - ~~c. the need to consult the licensee on its proposed determination, specified in CRC paragraph 3F.14 of CRC 3F, within 10 working days of receipt of a proposal under paragraph 3F.10 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph [7.56](#). If it has not, the proposed relevant adjustment will be rejected.
- (v) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it has carried out or commissioned.
- (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 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.

If the Authority decides to reject the licensee’s proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vii) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.
- (viii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

[7.607.59](#) A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Link Box 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 Regulatory Years.

~~7.617.60~~ If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Link Box Costs and does not make a relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.2019 of CRC 3F stipulates that the adjustments will be deemed to have been made.

~~7.627.61~~ The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCLB values under section 10 of this chapter.

## **Section 7 – Methodology for determining relevant adjustments in respect of Shetland Uncertain Energy Costs (SSEH only)**

### **The uncertainty mechanism for Shetland Uncertain Energy Costs**

~~7.637.62~~ The term Shetland Uncertain Energy Costs means costs incurred, or expected to be incurred by SSEH during the period between 1 April 2015 and the implementation of the enduring solution for Shetland, referred to in the Authority's open letter entitled "Ofgem's determination of Scottish Hydro Electric Power Distribution plc's (SHEPD) submission required under Charge Restriction Condition (CRC) 18A" dated 22 April 2014, to the extent that those costs are not otherwise recoverable under the Charge Restriction Conditions of the licence. This definition is set out in CRC 3F. The costs relate to:

- (a) power purchase agreements with the Sullom Voe Terminal on Shetland;
- (b) contingency costs (excluding fuel) relating to supply failure risks;
- (c) capital and operating costs for Lerwick power station (excluding fuel); and
- (d) costs of integrating solutions from the NINES project.

~~7.647.63~~ Some Shetland Uncertain Energy Costs were taken into account in setting the allowed expenditure levels for Regulatory Years 2015/16 to 2018/19 inclusive, used to calculate Opening Base Revenue Allowances for SSEH. The uncertainty mechanism provides for relevant adjustments to levels of allowed expenditure for these years in respect of:

- (a) material amounts of efficient costs that were not included in the calculation of Opening Base Revenue Allowances for SSEH (with respect to proposals made by SSEH); and
- (b) materially lower than expected levels of actual expenditure (with respect to proposals made by the Authority).

It does not provide for adjustments to be made in respect of other Regulatory Years in the Price Control Period which were set at and will remain at zero. This reflects the development of the enduring solution for Shetland ~~(see paragraph 7.73)~~.

*Application/proposal windows*

**7.657.64** SSEH may only give Notice of a proposed relevant adjustment during an application window that opens on 1 May 2017 and closes on 31 May 2017.

**7.667.65** The Authority may only give Notice of a proposed relevant adjustment during a window that opens on 1 December 2017 and closes on 31 December 2017.

*Overall materiality threshold*

**7.677.66** An overall materiality threshold applies in respect of relevant adjustments for Shetland Uncertain Energy Costs, whether proposed by the licensee or the Authority. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 6 to CRC 3F.

**7.687.67** If the materiality threshold is passed, because the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, it is not further taken into account in the determination of relevant adjustments to allowed expenditure levels.

**7.697.68** If the materiality threshold is not passed, because the proposed relevant adjustment (in 2012/13 prices) is, in total, less than the materiality threshold amount, then any relevant adjustment proposal will be rejected. However, in that case, the costs will be subject to the Totex Incentive Mechanism.

**Determination of a relevant adjustment proposed by the licensee**

**7.707.69** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Shetland Uncertain Energy 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 window referred to in paragraph **7.11**. If the Notice has been received before 1 May 2017, the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during May 2017. If the Notice has been received after 31 May 2017, 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.27 and 3F.28 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv)); and
  - b. costs that have been incurred, or that are forecast to be incurred, represent a necessary and 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 give

Notice of that requirement to the licensee as ~~soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking 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.20 of CRC 3F; and~~
- ~~c. the need to consult the licensee on its proposed determination specified in paragraph 3F.14 of CRC 3F, within 10 working days of receipt of a proposal under paragraph CRC3F.10 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed (see paragraphs ~~7.66 to 7.68~~~~7.6 to 7.8~~). 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 provisionally determine the adjustments to allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied, having regard to paragraph ~~7.63~~~~7.3~~.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vi) 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.

~~7.71~~7.70 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Shetland Uncertain Energy 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 those Regulatory Years.

~~7.72~~7.71 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Shetland Uncertain Energy Costs and does not make a relevant adjustment determination within four months of the close of the application window, and the proposal has not been withdrawn, then paragraph

3F.20 of CRC 3F stipulates that the adjustment will be deemed to have been made.

7.737.72 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSFE values under section 10 of this chapter.

## **Section 8 – Methodology for determining relevant adjustments in respect of Shetland Competitive Process Costs (SSEH only)**

### **The uncertainty mechanism for Shetland Competitive Process Costs**

7.747.73 The term Shetland Competitive Process Costs means costs incurred, or expected to be incurred by SSEH in implementing the competitive process referred to in the Authority’s open letter entitled “Ofgem’s determination of Scottish Hydro Electric Power Distribution plc’s (SHEPD) submission required under Charge Restriction Condition (CRC) 18A” dated 22 April 2014, to the extent that those costs are not otherwise recoverable under the Charge Restriction Conditions of the licence. This definition is set out in CRC 3F. The costs relate to:

- (a) the appointment and tasking of an independent auditor;
- (b) a public consultation process; and
- (b) a competitive tender process for the design of the enduring solution for Shetland,

as set out and expanded upon in the Authority’s letter referred to in paragraph 7.73-7.14.

7.757.74 Some Shetland Competitive Process Costs were taken into account in setting the allowed expenditure levels for Regulatory Years 2015/16 to 2018/19 inclusive, used to calculate Opening Base Revenue Allowances for SSEH. The uncertainty mechanism provides for relevant adjustments to levels of allowed expenditure for these years in respect of:

- (a) efficient costs that were not included in the calculation of Opening Base Revenue Allowances for SSEH (with respect to proposals made by SSEH); and
- (b) materially lower than expected levels of actual expenditure (with respect to proposals made by the Authority).

It does not provide for adjustments to be made in respect of other Regulatory Years in the Price Control Period which were set at and will remain at zero.

#### *Application/proposal windows*

7.767.75 SSEH may only give Notice of a proposed relevant adjustment during an application window that opens on 1 May 2017 and closes on 31 May 2017.

7.777.76 The Authority may only give Notice of a proposed relevant adjustment during a window that opens on 1 December 2017 and closes on 31 December 2017.



*Overall materiality threshold*

~~7.787.77~~ An overall materiality threshold applies in respect of relevant adjustments for Shetland Competitive Process Costs, whether proposed by the licensee or the Authority. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 7 to CRC 3F.

~~7.797.78~~ If the materiality threshold is passed, because the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, it is not further taken into account in the determination of relevant adjustments to allowed expenditure levels.

~~7.807.79~~ If the materiality threshold is not passed, because the proposed relevant adjustment (in 2012/13 prices) is, in total, less than the materiality threshold amount, then any relevant adjustment proposal will be rejected. However, in that case, the costs will be subject to the Totex Incentive Mechanism.

**Determination of a relevant adjustment proposed by the licensee**

~~7.817.80~~ If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Shetland Competitive Process 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 window referred to in paragraph ~~7.11-7.16~~. If the Notice has been received before 1 May 2017 the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during May 2017. If the Notice has been received after 31 May 2017 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.27 and 3F.28 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (iv)); and
  - b. costs that have been incurred, or that are forecast to be incurred, represent a necessary and 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 give Notice of that requirement to the licensee as ~~soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking 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.20 of CRC 3F; and~~
- ~~c. the need to consult the licensee on its proposed determination specified in paragraph 3F.14 of CRC 3F, within 10 working days of receipt of a proposal under paragraph CRC 3F.10 of CRC 3F.~~

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal.

- (iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs ~~7.77 to 7.79~~~~7.18 and 7.20~~. 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 provisionally determine the adjustments to allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied, having regard to paragraph ~~7.74-7.15~~.

If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

- (vi) 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.

~~7.827.81~~ A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Shetland Competitive Process 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 those Regulatory Years.

~~7.837.82~~ If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Shetland Competitive Process Costs and does not make a relevant adjustment determination within four months of the close of the application window, and the proposal has not been withdrawn, then paragraph 3F.20 of CRC 3F stipulates that the adjustment will be deemed to have been made.

~~7.847.83~~ The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCCPC values under section 10 of this chapter.

## Section 9 – Methodology for determining relevant adjustments in respect of Subsea Cable Costs (SSEH only)

### The uncertainty mechanism for Subsea Cable Costs

**7.857.84** The term Subsea Cable Costs means costs incurred, or expected to be incurred, by the licensee in applying recognised and approved measures to protect cables laid on the seabed beyond laying the cable on the seabed and securing it from the low tide mark as the cable emerges from the water in accordance with licensing requirements imposed by Marine Scotland, as further clarified in the RIGs. The definition is set out in CRC 3F.

**7.867.85** 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*

**7.877.86** An overall materiality threshold applies in respect of relevant adjustments for Subsea cables. The materiality threshold for the licensee, in 2012/2013 prices, is specified in the table in Appendix 8 to CRC 3F.

**7.887.87** 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 adjustments proposal will be rejected. This is without any 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

**7.897.88** If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Subsea Cable 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 either:
  - a. the application window referred to in paragraph **7.117.12**;
  - or
  - b. any later application window specified by the Authority in a direction made under the provisions of CRC 3F.

If the Notice has been received before the start of the applicable application window set out above, the Authority will notify the licensee that the notice has been received too early and should be resubmitted during the application window. If the notice has been received after the end of the applicable application window, 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 paragraph 3F.10 to 3F.12 has been met (except for the requirement in respect of material amount - see step (iv));
- b. the costs incurred or expected to be incurred fall within the definition of Subsea Cable Costs and have been or will be incurred during the Price Control Period;
- c. the licensee has applied recognised and approved measures to protect cables laid on the seabed beyond laying the cable on the seabed and securing it from the low tide mark as the cable emerges from the water in accordance with licensing requirements imposed by Marine Scotland;
- d. the costs are not recoverable from a third party; and
- e. 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 give Notice of that requirement to the licensee as ~~soon as reasonably practicable and will allow such time for provision of that information as appropriately 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.20; and~~

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

~~It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further information, analysis and reformatting requests in respect of the proposal specified under paragraph 3F.14 of CRC 3F, within 10 working days of receipt of a proposal under paragraph 3F.10 of CRC 3F.~~

(iv) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraph 7.98. If it has not, the proposed relevant adjustment will be rejected.

(v) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the result of any benchmarking or other comparative analysis that it has carried out or commissioned.

(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

~~7.907.89~~ 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.

~~7.91~~ If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made.

~~7.90~~

~~7.92~~ (i) The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.

~~7.91~~

~~7.937.92~~ (ii) The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

~~7.947.93~~ A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Subsea Cable 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 Regulatory Years.

~~7.957.94~~ If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Subsea Cable Costs and does not make an relevant adjustment determination within the relevant time limit prescribed in CRC 3F, and the proposal has not been withdrawn, then paragraph 3F.20 of CRC 3F stipulates that the adjustments will be deemed to have been made.

~~7.967.95~~ The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSC values under section 10 of this chapter.

## **Section 10 – Determination, notification and direction of revised PCFM Variable Values for uncertain cost activities**

~~7.977.96~~ CRC 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. Subject to paragraph ~~3F.20 of CRC 3F-7.112~~, it also specifies that revised PCFM Variable Values relating to uncertain cost activities will be directed by the Authority by the following Regulatory Years:

- By 30 November 2016 (or such later date as directed by the Authority) for Subsea Cable Costs;
- By 30 November 2017 for Shetland Uncertain Energy Costs and Shetland Competitive Costs;

- By 30 November 2018 for Link Box Costs; and
- By 30 November 2019 for all other uncertain cost activities.

### **Determination of revised PCFM Variable Values**

7.987.97 On or before 31 October in the relevant direction deadline year, Ofgem will check to see whether any determinations of relevant adjustments have been made or have been deemed to have been made in respect of

- (a) High Value Project Costs;
- (b) Enhanced Physical Site Security Costs;
- (c) Specified Street Works Costs;
- (d) Rail Electrification Costs;
- (e) Shetland Uncertain Energy Costs;
- (f) Shetland Competitive Process Costs;
- (g) Link Box Costs; and
- (h) Subsea Cable Costs<sup>7.2</sup>

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.

7.997.98 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.

7.1007.99 The PCFM Variable Values referred to in paragraph 7.627.107 are:

- (a) UCHVP values in respect of High Value Project Costs;
- (b) UCEPS values in respect of Enhanced Physical Site Security Costs;
- (c) UCSSW values in respect of Specified Street Works Costs;
- (d) UCRE values in respect of Rail Electrification Works Costs;
- (e) UCSFE values in respect of Shetland Uncertain Energy Costs;
- (f) UCCPC values in respect of Shetland Competitive Process Costs;
- (g) UCLB values in respect of Link Box Costs; and
- (h) UCSC values in respect of Subsea Cables costs.

### **Notification and direction of revised PCFM Variable Values**

7.1017.100 The Authority will give Notice of any revisions to UCHVP, UCEPS, UCSSW, UCRE, UCSFE, UCCPC, UCLB and UCSC values that it proposes to direct by 15 November in the relevant direction deadline year, 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 CRC 3F, which cross refers to this chapter of this 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.

7.1027.101 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.

7.1037.102 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**

7.1047.103 If the procedures set out in CRC 3F and this chapter call for the Authority to direct revised PCFM Variable Values for one or more uncertain cost categories ~~noticeby~~ within four months of the close of the relevant application window, and the Authority does not make such a direction, then CRC 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

## 8. Smart Meter Roll-out Costs- financial adjustment methodology

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### Section 1 - 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 intervene (make "Smart Meter Interventions") in a significant number of Smart Meter Installations where work on Distribution System assets is required to facilitate the fitting of smart meters. The provisions of 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 Costs is commensurate with efficient management of that activity.

8.2 Opening levels of allowed Totex expenditure for Smart Meter Roll-out Costs for each Regulatory Year of the Price Control Period were set on a provisional basis because of uncertainties surrounding the number of Smart Meter Installations that would take place and the number of Smart Meter Installations where the licensee would be required to make a Smart Meter Intervention. 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, the PCFM Variable Values associated with Smart Meter Roll-out Costs for the licensee (SMAE values) 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 levels of allowed expenditure on Smart Meter Roll-out Costs and associated SMAE values are to be revised during the Price Control Period.

8.5 For Regulatory Year 2022/23 SMAE values are subject to revision only in respect of the tapering factor true-up referred to in section 3 below (unless the Authority directs otherwise under paragraph 3E.10 of CRC 3E).

8.6 Levels of allowed expenditure and SMAE values for Regulatory Years from 2015/16 to 2021/22 are to be revised using the formula set out in Part B of CRC 3E. The calculation under the formula uses:

- (a) the total number of Smart Meter Interventions in the licensee's Distribution Services Area (DSA) during Regulatory Year t-2; and
- (b) the licensee's allowed unit cost of Smart Meter Interventions, in 2012/13 price, specified for the licensee in Appendix 1 of CRC 3E (and subject to revision by direction of the Authority under paragraph 3E.8 of CRC 3E).

8.7 Under the Annual Iteration Process, allowed expenditure levels on Smart Meter Roll-out Costs, represented by SMAE 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 (see chapter 6).

## Section 2 - Determination of revised SMAE values for Regulatory Years 2015/16 to 2021/22

8.8 The formula contained in Part B of CRC 3E is expressed as calculating SMAE values for Regulatory Year t-2 and this is explained in paragraphs 8.9 to [8.11](#) below.

8.9 The Authority will determine a revised SMAE value for Regulatory Year 2015/16 by applying the number of Smart Meter Interventions the licensee was required to make during Regulatory Year 2015/16 to the formula contained in Part B of CRC 3E. This determination, and the direction of the revised SMAE value for 2015/16 will take place by 30 November 2016 for use in the Annual Iteration Process that will take place by the same date. This Annual Iteration Process will produce the value of the term MOD for Regulatory Year 2017/18 which, under the temporal convention set out in paragraphs 1.9 to 1.11 of chapter 1, is Regulatory year t. Therefore, in the context of this Annual Iteration Process, Regulatory Year 2015/16 is Regulatory year t-2.

8.10 The SMAE value for Regulatory Years 2016/17 to 2021/22 and the expected timetable for the revision of SMAE values and their use in the Annual Iteration Process is set out in Table 8.1 below.

**Table 8.1 – Routine timing for determination and use of revised SMAE values for Regulatory Years 2015/16 to 2021/22**

<b>Regulatory Year t-2 during which activity takes place</b>	<b>Revised SMAE value for Regulatory Year t-2 determined by</b>	<b>Reflected in value of MOD for Regulatory Year</b>
2015/16	30 Nov 2016	2017/18
2016/17	30 Nov 2017	2018/19
2017/18	30 Nov 2018	2019/20
2018/19	30 Nov 2019	2020/21
2019/20	30 Nov 2020	2021/22
2020/21	30 Nov 2021	2022/23
2021/22	30 Nov 2021	2022/23

8.11 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 the number of Smart Meter Interventions it was required to make in the Regulatory Year concerned. In those circumstances the revision to the SMAE value concerned would again be

determined using the formula contained in Part B of CRC 3E, but using the restated Smart Meter Interventions number for the Regulatory Year in question.

### **Section 3 - Determination of revised SMAE value for Regulatory Year 2022/23**

#### **SMAE true-up**

8.12 Revision of the SMAE value for Regulatory Year 2022/23 gives effect to a true-up mechanism that:

- (a) corrects for any under or over statement of the numbers of Smart Meter Interventions used in the determination of SMAE values for Regulatory Years 2015/16 to 2021/22 under Part B of CRC 3E and section 2 of this chapter; and
- (b) applies a tapering factor that was incorporated to recognise economies of scale and to incentivise the licensee to minimise intervention levels.

8.13 The outcome of the true-up mechanism and its impact on the revised SMAE value for Regulatory Year 2022/23 will be determined using the formula set out in Part C of CRC 3E. The calculation under the formula uses:

- (a) the total number of Smart Meter Interventions for Regulatory Years from 2015/16 to 2021/22;
- (b) the total number of Smart Meter Installations in the licensee's DSA for Regulatory Years from 2015/16 to 2021/22;
- (c) the licensee's allowed unit cost of Smart Meter Interventions, in 2012/13 price, specified for the licensee in Appendix 1 of CRC 3E (which is subject to revision by direction of the Authority under paragraph 3E.8 of CRC 3E);
- (d) the tapering factors for the licensee that are specified in Table 2 contained in Part C of CRC 3E (which is subject to revision by direction of the Authority under paragraph 3E.10 of CRC 3E); and
- (e) the latest SMAE values directed for Regulatory Years 2015/16 to 2021/22.

8.14 The Authority will determine a revised SMAE value for Regulatory Year 2022/23 by 30 November 2021 for use in the Annual Iteration Process that will take place by 30 November 2021<sup>30</sup>. This Annual Iteration Process will produce the value of the term MOD for Regulatory Year 2022/23. This timing is set out in Table 8.2 below.

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<sup>30</sup> Note that "SMAE value for Regulatory Year 2022/23" means the SMAE value in the 2022/23 column of the PCFM Variable Values Table, so there is no contradiction in stating that it will be revised by 30 November 2021 (see paragraph 1.10).

**Table 8.2 – Timing for determination and use of a revised SMAE value for Regulatory Year 2022/23**

<b>Regulatory Year t-2 during which activity takes place</b>	<b>Revised SMAE value for Regulatory Year 2022/23 determined by</b>	<b>Reflected in value of MOD for Regulatory Year</b>
-	30 Nov 2021	2022/23

8.15 Paragraph 3E.10 of CRC 3E specifies that the Authority can direct that the SMAE value for Regulatory Year 2022/23 is to be revised on a different basis.

### **Regulatory Year 2022/23**

8.16 It is expected that the roll-out of smart meters by electricity suppliers will be completed by the end of Regulatory Year 2021/22. Consequently there is no routine provision in CRC 3E or this chapter for SMAE values for Regulatory Year 2022/23 to be revised in respect of Smart Meter Interventions in ~~those that~~ years. However, under paragraph 3E.9 of CRC 3E, the Authority can direct that the SMAE value for Regulatory Year 2022/23 can be a value other than zero.

## **Section 4 - Notification and direction of revised PCFM Variable Values**

8.17 Paragraph 3E.16 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 the Authority will give notice to the licensee as shown in column 2 of Table 8.3 below.

**Table 8.3 – Expected timings for SMAE value Notices and Directions**

<b>Regulatory Year for which SMAE value is being revised</b>	<b>Deadline for Notice of proposed revision to SMAE value</b>	<b>Deadline for direction of revised SMAE value</b>
2015/16	15 Nov 2016	30 Nov 2016
2016/17	15 Nov 2017	30 Nov 2017
2017/18	15 Nov 2018	30 Nov 2018
2018/19	15 Nov 2019	30 Nov 2019
2019/20	15 Nov 2020	30 Nov 2020
2020/21	15 Nov 2021	30 Nov 2021
2021/22	15 Nov 2021	30 Nov 2021
2022/23	15 Nov 2021	30 Nov 2021

8.18 The Authority is required to have due regard to any representations made by the licensee in respect of proposed revisions to SMAE values and to give its reasons for any decisions in relation to them.

8.19 Having complied with the notice requirements referred to in paragraph 8.17, the Authority will direct revised SMAE values as shown in column 3 of Table 8.3.

*Delay in direction of revised PCFM Variable Values*

8.20 If, for any reason, the Authority does not give a required direction of an SMAE value by the date shown in column 3 of Table 8.3, CRC 3E requires that the value 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

## 9. Load Related Expenditure - financial adjustment methodology

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### Section 1 – Overview

9.1 The Authority's ED1 Strategy Decision document (see associated document a7) stated that the licensee's opening allowed levels of Load Related Expenditure might need to be adjusted during the Price Control Period to accommodate new and changing patterns of electricity use by electricity consumers. Accordingly, CRC 3G (Revising the allowed level of Load Related Expenditure) sets out a mechanism for 'relevant adjustments' to the licensee's allowed levels of Load Related Expenditure. Relevant adjustments may be positive or negative.

9.2 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; and
- represented by the opening values of the PCFM Variable Value for allowed Load Related Expenditure for the licensee (LRRC values).

9.3 CRC 3G sets out:

- the application windows during which relevant adjustment proposals can be made;
- the criteria for the proposal of relevant adjustments;
- the basis on which the Authority will determine relevant adjustments; and
- the basis on which the Authority will determine and direct revised LRRC values for the licensee.

9.4 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.

9.5 The provisions of CRC 3G and this chapter mean that revised allowed levels of Load Related Expenditure (represented by revised LRRC values) can be included in the Annual Iteration Process for the ED1 Price Control Financial Model (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.

9.6 The effects of revising LRRC values for Regulatory Years in the Price Control Period 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.

## Section 2 – Determination of revisions to allowed levels of Load Related Expenditure

9.7 CRC 3G provides for:

- the licensee to propose revisions to allowed levels of expenditure (relevant adjustments), but only during two application windows specified in CRC 3G (see paragraph 9.9);
- the determination of relevant adjustments by the Authority; and
- the deeming of relevant adjustments in circumstances specified in CRC 3G.

9.8 CRC 3G also provides for the Authority to propose relevant adjustments in relation to allowed levels of Load Related Expenditure during a notice window after the end of the Price Control Period, specified in CRC 3G (see paragraph 9.10).

9.9 The application windows during which the licensee can propose relevant adjustments run from:

- (i) 1 May 2017 to 31 May 2017; and
- (ii) 1 May 2020 to 31 May 2020.

9.10 The notice window during which the Authority can give notice of proposed relevant adjustments runs from 1 September 2023 to 30 September 2023. This window is after the end of the Price Control Period whose last day is 31 March 2023.

9.11 CRC 3G 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) the determination of relevant adjustments proposed by the licensee; and
- (b) the determination and direction of revised LRRC values to give effect to determinations made under subparagraph (a).

9.12 Relevant adjustments proposed by the Authority are not effected through revisions to LRRC values for Regulatory Years in the Price Control Period and consequently are not dealt with further in this chapter.

### Relevant adjustment proposals by the licensee

9.13 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.6 to 3G.13 in CRC 3G.

9.14 A relevant adjustment proposal by the licensee must:

- (i) be based on information about the licensee's level of efficient Load Related Expenditure over the Price Control Period that was not available when the licensee's Opening Base Revenue Allowances were determined;

- (ii) take account of any relevant adjustments previously determined under CRC 3G;
- (iii) constitute a material amount, being an amount that satisfies the test specified in paragraph 3G.7 of CRC 3G;
- (iv) relate only to costs incurred and income from customer contributions received during the Price Control Period; and
- (v) constitute an adjustment to allowed expenditure that cannot be made under the provisions of any other Charge Restriction Condition.

9.15 A relevant adjustment proposal by the licensee 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) any change to the licensee's Specific Customer Funded Reinforcement Percentage Band that is proposed;
- (iii) the basis on which proposed changes to the licensee's allowed levels of Load Related Expenditure have been calculated; and
- (iv) appropriate supporting evidence including actual and forecast changes in network loading.

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

9.16 In accordance with CRC 3G, the Authority will determine the 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 each of the application windows referred to in paragraph 9.9 – ie by 30 September 2017 and 2020 unless the timetable is extended by the Authority in the circumstances and to the extent prescribed in CRC 3G. The determination of relevant adjustments will be made in accordance with the provisions of CRC 3G and this chapter.

9.17 A determination under paragraph 3G.17 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 for which LRRC values are to be revised, which may be any of the Regulatory Years in the Price Control Period.

9.18 If the Authority has not determined a relevant adjustment in relation to a proposal duly made by the licensee in respect of Load Related Expenditure within the relevant time limit prescribed by CRC 3G, and the proposal has not been withdrawn, then the relevant adjustment, insofar as it relates to a revision to allowed expenditure levels and LRRC values for the licensee for the Regulatory Years specified in the proposals, will be deemed to have been made.

9.19 In determining any relevant adjustment, the Authority will:

- (a) consult with the licensee and other interested parties and take account of any representations made in responses;
- (b) have regard to the basis on which opening LRRC values were determined;

- (c) 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;
- (d) consider the value of any off-setting demand-side response solutions or use of other non-traditional reinforcement solutions, above or below the level taken into account by the Authority in setting the licensee's Opening Base Revenue Allowances, that have avoided or, as may be, are reasonably expected to avoid, Load Related Expenditure;
- (e) consider whether the licensee's Load Related Expenditure has fallen outside any Specific Customer Funded Reinforcement Percentage Band under CRC 5G (Net to gross adjustment for Load Related Expenditure); and
- (f) check that the restriction specified in paragraph 3G.10 of CRC 3G has been included in the licensee's calculations (see paragraph 9.15 (iii)) and, if not, apply the restriction, if appropriate, in making its determination.

9.20 The stipulation in paragraph 9.19(d) means that the Authority may, in a relevant adjustment determination, include an uplift to the licensee's allowed expenditure levels in respect of expenditure by the licensee on demand-side response solutions and non-traditional reinforcement solutions, where it considers that such expenditure has avoided or is expected to avoid the need for Load Related Expenditure.

9.21 The restriction referred to in paragraph 9.19(f) is that a relevant adjustment proposed or made under CRC 3G must not exceed:

- (a)  $TLRRCF - TLRRCoV - (20\% \times TLRRCoV)$   
where  $TLRRCF > TLRRCoV$ ; or
- (b)  $TLRRCF - TLRRCoV + (20\% \times TLRRCoV)$   
where  $TLRRCF < TLRRCoV$

where:

$TLRRCoV$  means the total of opening level of allowed levels of Load Related Expenditure for the licensee; and

$TLRRCF$  means the proposed revised total level of allowed Load Related Expenditure for the licensee.

9.22 Any determination of a relevant adjustment will specify:

- (a) the Regulatory Years to which any changes to allowed levels of Load Related Expenditure apply;
- (b) the revised allowed level of Load Related Expenditure for the licensee (in 2012/13 prices) for each of the Regulatory Years specified under subparagraph (a); and
- (c) the revised LRRC values representing the allowed expenditure levels referred to in subparagraph (b).



### Section 3 - Notification and direction of revised PCFM Variable Values for Load Related Expenditure (LRRC values)

9.23 The Authority will give Notice to the licensee of any revisions to LRRC values that it proposes to direct:

- by 15 November 2017 in respect of relevant adjustments proposed by the licensee during the first application window; and
- by 15 November 2020 in respect of relevant adjustments proposed by the licensee during the second application window.

9.24 The Notice will confirm that:

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

9.25 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.

9.26 Having complied with the notice requirements, the Authority will direct revised LRRC values for the Regulatory Years specified in its determination (or in respect of a deemed adjustment – see paragraph 9.18) by 30 November in the Regulatory Year t-1 concerned.

9.27 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**

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

#### **Delay in direction of revised PCFM Variable Values**

9.28 If the Authority does not make one of the directions required under paragraph 9.26 by 30 November in the Regulatory Year t-1 concerned, then CRC 3G 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

## 10. Visual Amenity Projects - financial adjustment methodology

### Section 1 – Overview

10.1 Under the RIIO-ED1 price control arrangements the licensee has been allocated a total visual amenity allowed expenditure amount for the Price Control Period. CRC 3J (Allowed expenditure on Visual Amenity Projects) 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 Regulatory Instructions and Guidance (RIGs) provide 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 term. At the outset of the Price Control Period on 1 April 2015, the VAA values for the licensee for each Regulatory Year of the Price Control Period are 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:

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

where:

- TVAA means the licensee's total visual amenity allowed expenditure for the Price Control Period, as specified for the licensee in Appendix 1 to CRC 3J, expressed in 2012/13 prices; and
- $VAE_{t-2}$  means the amount spent by the licensee in Regulatory Year t-2 on Visual Amenity Projects expressed in 2012/13 prices.

10.4 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, VAA values, 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*

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

**Section 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 by the licensee in accordance with 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 the Authority in accordance with the RIGs. 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 the pattern shown in Table 10.1.

10.9 It should be noted that if the licensee has used up all of its total visual amenity allowed expenditure for the Price Control Period, the application of the formula in CRC 3J (reproduced in paragraph 10.3) 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**

<b>Regulatory Year t-2 during which Visual Amenity Project expenditure takes place</b>	<b>Revised VAA value determined by</b>	<b>Reflected in value of MOD for Regulatory Year</b>
2015/16	30 Nov 2016	2017/18
2016/17	30 Nov 2017	2018/19
2017/18	30 Nov 2018	2019/20
2018/19	30 Nov 2019	2020/21
2019/20	30 Nov 2020	2021/22
2020/21	30 Nov 2021	2022/23

10.10 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 (2021/22 and 2022/23) will not be available in time to be included in a value for the term MOD. Therefore, adjustments to allowed expenditure on Visual Amenity Projects in 2021/22 and 2022/23 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 VAA values in the licence and this handbook in the form they are in as at 31 March 2023. For the avoidance of doubt these arrangements will include Time Value of Money Adjustments and take into account the provisions relating to the licensee's total visual amenity allowed expenditure for the Price Control Period.

10.11 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**

10.12 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 revisions of VAA values 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.

10.13 Having complied with the Notice requirements referred to in paragraph 10.12, and subject to paragraphs 10.8 and 10.10 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*

10.14 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

## 11. Worst Served Customer Projects - financial adjustment methodology

### Section 1 – Overview

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

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 allocated a total amount of allowed expenditure on Worst Served Customer Projects. The definition of a Worst Served Customer is contained in CRC 3H which also sets out the Worst Served Customer Required Performance Improvement that the licensee must seek to ensure is delivered. Further information is contained in the Regulatory Instructions and Guidance (RIGs).

11.3 The licensee's allowed expenditure level on Worst Served Customer Projects 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 CRC 3H provides for the determination of the licensee's allowed expenditure levels on Worst Served Customer Projects 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:

$$WSCC_{t-2} = \min \left( WSE_{t-2}, TWSCC - \sum_{2015/16}^{t-3} WSCC_t \right)$$

where:

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

**WSE<sub>t-2</sub>** means, subject to paragraph 3H.8 in CRC 3H, the amount spent by the licensee in Regulatory Year t-2 on Worst Served Customer Projects, expressed in 2012/13 prices.

- 11.5 In addition, the licensee must:
- (a) ensure that the total amount of expenditure on improving services to Worst Served Customers included in values for the term WSE for the Price Control Period does not exceed an amount calculated as:

$$WSCCPC \times TWSC$$

where:

WSCCPC means the Value for the Worst Served Customer Cap Per Customer for the licensee set out in Appendix 2 of CRC 3H; and

TWSC means the total number of Worst Served Customers included in Worst Served Customer Projects during the Price Control Period;

and

- (b) seek to ensure that its expenditure on Worst Served Customer Projects delivers to Worst Served Customers the Required Performance Improvement set out in Appendix 3 of CRC 3H.

11.6 For the avoidance of doubt, the reference in paragraph ~~11.5~~(a) to the total amount of expenditure on improving services to Worst Served Customers included in values for the term WSE for the Price Control Period includes expenditure in Regulatory Years 2021/22 and 2022/23 (see also paragraph 11.13).

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*

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

## **Section 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 Worst Served Customer Projects (contained in CRC 3H and reproduced in paragraph 11.4 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 Worst Served Customer Projects in each Regulatory Year will be reported by the licensee in accordance with the

RIGs. The reported values of expenditure will initially be used to calculate provisional WSCC values. These provisional values may subsequently be revised where Worst Served Customer Projects do not deliver the required performance improvement. The provisional values will also be subject to an assessment of expenditure per customer as part of the close out process for the entire ED1 period.

*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 Worst Served Customer Projects for Regulatory Year 2015/16 to the Authority in accordance with the RIGs. 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 the pattern shown in Table 11.1 below.

11.12 It should be noted that, if the licensee has used up all of its total allowed expenditure (TWSCC) for the price control period the application of the formula in CRC 3H (reproduced in paragraph 11.4) 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**

<b>Regulatory Year t-2 during which project expenditure takes place</b>	<b>Revised WSCC value determined by</b>	<b>Reflected in value of MOD for Regulatory Year</b>
2015/16	30 Nov 2016	2017/18
2016/17	30 Nov 2017	2018/19
2017/18	30 Nov 2018	2019/20
2018/19	30 Nov 2019	2020/21
2019/20	30 Nov 2020	2021/22
2020/21	30 Nov 2021	2022/23

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 Worst Served Customer Projects for the last two Regulatory Years of the Price Control Period (2021/22 and 2022/23) 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 2021/22 and 2022/23 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 these arrangements will include Time Value of Money Adjustments and take into account 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 set out in Appendix 2 of CRC 3H.

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 Worst Served Customer Projects 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 revisions of WSCC values 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 11.11 and 11.13, 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

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

### Section 1 - Overview

12.1 CRC 3D (The Innovation Roll-out Mechanism) 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 have been 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 ED1 Price Control Financial Model (PCFM) and the values for the term MOD.

12.6 CRC 3D provides for:

- the licensee to propose revisions to levels of allowed expenditure (Relevant Adjustments), but only during either or both 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 2019 to 31 May 2019.

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 Years 2020/21, 2021/22 and 2022/23.

12.9 Paragraph 3D.13 of CRC 3D 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.9 of CRC 3D (see paragraph 12.10);
- (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), the meaning of 'material amount' is given at paragraph 3D.9 and Appendix 1 of CRC 3D.

12.11 The Authority will 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 section 2 of this chapter. Section 3 of this chapter provides for the determination and direction of 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.

## **Section 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 an application window 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.13 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 give Notice of that requirement to the licensee as soon as reasonably practicable and will allow such time for provision of that information as appropriate, taking 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.15 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.

If the Authority considers that the proposed Relevant Adjustment should not be made it will provisionally determine that no adjustments to allowed expenditure should be made.
- (vi) 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 section in the determination of revised IRM values under section 3 of this chapter.

### **Section 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 Year 2017/18 and each subsequent Regulatory Year up to and including 2021/22, Ofgem will check to see whether any determinations of Relevant Adjustments have been made in respect of Innovation Roll-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 referred to in the determinations.

12.17 If determinations of Relevant Adjustments have not previously been taken into account, the Authority will determine that the IRM values for the Regulatory Years concerned are to be revised so that they take 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 Year 2017/18 and each subsequent Regulatory Year up to and including 2021/22, being at least 14 days before the deadline date of 30 November in each of those Regulatory 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 revisions to IRM values 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 CRC 3D and this chapter call for the Authority to direct revised IRM values by 30 November 2017 or by 30 November in a subsequent Regulatory Year, 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 CRC 4B (Annual Iteration Process for the PCFM).



## 12A. Not used

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## 12B. Moorside allowed expenditure – financial adjustment [~~(ENWL only)~~]

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### Section 1 - Overview

12B.1 The term 'Moorside Costs' refers to costs incurred, or expected to be incurred, by ENWL for the purposes of connecting the proposed nuclear power station at Moorside on the west coast of Cumbria to the GB Transmission System. They are net of any ~~changes (including savings)~~ that ENWL has made or forecasts to make as a result of the Moorside Connection Project. This definition and related definitions are set out in CRC ~~3X-3L~~ Arrangements for the recovery of Moorside Costs.

12B.2 The uncertainty mechanism provides for adjustments in respect of efficient costs that were not included in the calculation of the licensee's Opening Base Revenue Allowances.

12B.3 To the extent that they comply with the general definition of Moorside Costs the following non-exhaustive ~~e~~Cost categories are capable of being considered as Moorside costs:

- (a) direct and indirect costs associated with the project, including temporary works;
- (b) costs associated with wayleave and easement negotiation, transfer and purchase;
- (c) costs associated with temporary and replacement telecommunications provision;
- (d) additional work required as a consequence of planning consents;
- (e) negative changes to other aspects of ENWL's planned work as a direct consequence of the project;
- ~~(f) Transmission Connection Point Charges;~~
- ~~(fg)~~ the connection of Moorside demand to the licensee's network; and
- ~~(gh)~~ any changes to connection costs resulting from changing network capacity (including payments of any distributed generation capacity constraints).

### Section 2 - Determination of Provisional and Firm adjustments to UCMC values

#### Materiality threshold

12B.4 A materiality threshold applies in respect of applications for firm adjustments to UCMC values. The materiality threshold relates to the aggregate



amount of the adjustments to Moorside Costs applied for under the relevant Notice and is specified in 2012/13 prices in the table in Appendix 1 to CRC 3L~~X~~.

12B.5 If the materiality threshold is passed, it is not taken further into account in the determination of provisional or firm adjustments to allowed expenditure levels. If the materiality threshold is not passed, then the adjustment proposal will be rejected.

### Application window

12B.6 ENWL may only apply for a relevant adjustment to Moorside Costs after and within 5 Working Days ~~of NGET giving Notice to~~ the Authority notifying it directly in Writing that it has commenced the Moorside Detailed Project Assessment, under Part F of special condition 6I of its licence in respect of the connection of Moorside to the GB Transmission System

12B.7 If the Authority receives Notice of a proposed adjustment from ENWL in respect of Moorside 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 circumstances referred to at paragraph 3L.4(a) and 3L.4(b) ~~of CRC 3L apply. If they do not the Authority will notify ENWL that its Notice is invalid.~~
- (ii) The Authority will check whether
  - a. each of the requirements set out in paragraphs 3L.8, 3L.9 and 3L.10 of CRC 3L has been met (except for the requirement in respect of a material amount – see step (iv));
  - b. the costs incurred or expected to be incurred fall within the definition of Moorside Costs and have been or will be incurred during the Price Control Period;
  - c. ENWL’s proposal sufficiently demonstrates that the additional costs proposed to be recovered will be efficiently and economically incurred (taking account of the interests of electricity consumers generally);
  - d. ENWL has developed sufficiently robust plans and risk sharing arrangements to be able to ensure that the Moorside Costs remain efficiently incurred; and
  - e. risk in relation to the Moorside Connection Project is shared appropriately between the licensee, NGET the Transmission Licensee and consumers.

- (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 give Notice of that requirement to the licensee as soon as reasonably practicable and will allow such time for provision of that information as appropriately takes account of:
  - a. the amount of time that the licensee will reasonably require to compile the information; and
  - b. 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 12B.4 and 12B.5. If it has not, the proposed relevant adjustment will be rejected.
- (v) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it has carried out or commissioned.
- (vi) If the Authority has not consulted on a determination of firm adjustments of UCMC values by 1 October in the Regulatory Year in which the Authority receives Notice from ENWL of a proposed adjustment in respect of Moorside Costs, steps (vii) to (viii) will apply.
- (vii) The Authority will consult with ENWL and any other such persons it considers appropriate on such provisional adjustments, if any, of UCMC values as it considers appropriate, ~~allowing the licensee 21 days in which to respond.~~
- (viii) The Authority will consider any consultation response from the licensee and will then determine such provisional adjustments, if any, of UCMC values as it considers reasonable.
- (ix) The provisional adjustments to UCMC values will apply for the purposes of calculating MODt unless and until the Authority determines firm adjustments of UCMC values.
- (x) Having carried out steps (i) to (vi) above, the Authority will, subject to the consultation described in steps (xi) and (xii), determine on a firm basis whether to:
  - a. reject the adjustment proposed by the licensee;
  - b. confirm the adjustment proposed by the licensee; or

- c. amend the adjustment proposed by the licensee.

If the Authority decides to amend or confirm the licensee's proposal it will, subject to the consultation described in steps (x) and (xi), determine firm adjustments to UCMC values that should be made and the Regulatory Years to which those adjustments should be applied.

If the Authority decides to reject the licensee's proposal it will, subject to the consultation described in steps (x) and (xi), and it has not determined any provisional adjustments to UCMC values, it will determine on a firm basis that no adjustments to allowed expenditure should be made.

If the Authority decides to reject the licensee's proposal it will, subject to the consultation described in steps (x) and (xi), but has determined provisional adjustments to UCMC values, it will determine on a firm basis that all UCMC values for the Price Control Period should revert to zero.

- (xi) The Authority will consult the licensee on its proposed firm determination, allowing the licensee at least 28 days in which to respond.
- (xii) The Authority will consider any consultation responses from the licensee and will then determine firm adjustments, if any, to UCMC values.

12B.8 A determination to make provisional or firm adjustments to UCMC values will specify:

- (a) the Regulatory Years to which that determination applies; and
- (b) the revised total amounts of allowed Totex expenditure (in 2012/13 prices) for each of the Regulatory Years, including tax treatment within the PCFM, as provided for in the licence.

12B.9 The Authority will ~~direct apply~~ any provisional or firm adjustments of revised UCMC values under section 45 of this chapter.

12B.10 If the Authority determines under 3L.18 or 3L.28 that adjustments to the licensee's PTPE values should be made, it will do so by:

- (a) Calculating the increase or decrease in allowed Transmission Connection Point Charges associated with the Moorside Connection Project, for each relevant Regulatory Year, and converting these to 2012-13 prices.

- (b) Calculating the revised values of 'Non-controllable opex (Exit Charges)' to be included in the PCFM by adding the change calculated in step (a) to the existing values for each relevant Regulatory Year.
- (c) Calculating the revised PTPE values for inclusion in Appendix 3 of CRC2B by adding the change calculated in step (a) to the existing values for each relevant Regulatory Year.

12B.11 A determination to make adjustments to PTPE values will specify:

- (a) the Regulatory Years to which that determination applies;
- (b) the revised total amounts of 'Non-controllable opex (Exit Charges)' (in 2012/13 prices) for each relevant Regulatory Years to be included in the PCFM; and
- (c) the revised total amounts of revised PTPE values for inclusion in Appendix 3 of CRC2B for each relevant Regulatory Years.

12B.12 The Authority will direct any adjustments of revised 'Non-controllable opex (Exit Charges)' or PTPE values under section 5 of this chapter.

12B.13 The Authority will consult the licensee on its proposed determination, allowing the licensee at least 28 days in which to respond.

12B.14 The Authority will consider any consultation responses from the licensee and will then determine adjustments, if any, to PTPE values.

### **Section 3 – Adjustment of UCMC values for Qualifying Adjustment Events following a determination of a firm adjustment of UCMC values**

*Circumstances in which an application may be made*

12B.15 ENWL may only apply for an adjustment of UCMC values for Qualifying Adjustment Events in the following circumstances:

- (a) the Authority has previously determined a firm adjustment of UCMC values other than for the purposes of reversing a provisional adjustment of UCMC values; and
- (b) it does so as soon as reasonably practicable and in any event within:
  - (i) three months after the end of the Regulatory Year in which the it occurred; or
  - (ii) by such later date as the Authority may notify to ENWL.

12B.16 If the Authority receives Notice from ENWL of a proposed adjustment of UCMC values in consequence of an **Qualifying** Adjustment Event it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended.

*Materiality threshold*

12B.17 A materiality threshold applies in respect of applications in respect of **Qualifying** Adjustment Events and is set out in Appendix 1 to CRC 3L. The materiality threshold applies to aggregate changes in expenditure to be incurred in relation to Moorside Costs which are caused by a change in the scope of ENWL Works as a result of an **Qualifyin** Adjustment Event before the application of the TIM.

12B.18 If the materiality threshold is passed, it is not taken further into account in the determination of provisional or firm adjustments to allowed expenditure levels. If the materiality threshold is not passed, then the 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 steps*

- (i) The Authority will check whether the circumstances referred to at paragraph ~~{●}~~**3L.21** apply. If they do not the Authority will notify ENWL that its Notice is invalid.
  
  - (ii) The Authority will check whether
    - a. each of the requirements set out in paragraphs 3L.24, ~~and~~ 3L.25 ~~and~~ **3L.26** of CRC 3L has been met (except for the requirement in respect of a material amount – see step (iv));
  
    - b. the Adjustment Event has occurred, ~~and it is a Qualifying Adjustment Event~~;
  
    - c. the application relates to costs which:
      - ~~(i) d.~~ fall within the definition of Moorside Costs;
  
      - ~~(ii) e.~~ have been or will be incurred during the Price ~~\_\_\_\_\_~~ Control Period;
  
      - ~~(iii) f.~~ have been or will be incurred as a result of the ~~\_\_\_\_\_~~ Adjustment Event;
  
      - ~~(iv) g.~~ comply with the requirements of ~~\_\_\_\_\_~~ paragraph ~~3X~~**3L.22** of CRC ~~3X~~**3L**;
- ~~\_\_\_\_\_~~ and

Ad. allowed expenditure for Moorside Costs will remain economical and efficient as a result of the Adjustment Event, including tax treatment within the PCFM, as provided for in the licence.

- (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 give Notice of that requirement to the licensee as soon as reasonably practicable and will allow such time for provision of that information as appropriately takes account of:
- a. the amount of time that the licensee will reasonably require to compile the information; and
  - b. the need to consult the licensee on its proposed determination.
- (iv) The Authority will check whether the materiality threshold has been passed in accordance with paragraph 12B.12. If it has not, the proposed relevant adjustment will be rejected.
- (v) In reviewing the level of costs included in any relevant adjustment proposal, the Authority will take into account the results of any benchmarking or other comparative analysis that it has carried out or commissioned.
- (vi) Having carried out steps (i) to (iv) above, the Authority will, subject to the consultation described in steps (vii) and (viii), determine on a firm basis whether to:
- a. reject the adjustment proposed by the licensee;
  - b. confirm the adjustment proposed by the licensee; or
  - c. amend the adjustment proposed by the licensee.

If the Authority decides to amend or confirm the licensee's proposal it will, subject to the consultation described in steps (vii) and (viii), determine adjustments to UCMC values that should be made and the Regulatory Years to which those adjustments should be applied.

If the Authority decides to reject the licensee's proposal it will, subject to the consultation described in steps (vii) and (viii), it will determine on a firm basis that no adjustments to allowed expenditure should be made.

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

- (viii) The Authority will consider any consultation responses from the licensee and will then determine further adjustments, if any, to UCMC values.

12B.19 A determination to make further adjustments to UCMC values will specify:

- (a) the Regulatory Years to which that determination applies; and  
(b) the revised total amounts of allowed Totex expenditure (in 2012/13 prices) for each of the Regulatory Years, including tax treatment within the PCFM, as provided for in the licence.

12B.20 The Authority will ~~directly~~ apply any further adjustments of revised UCMC values under section 4 of this chapter.

#### **Section 4 – Determination, notification and direction of provisional and final revised UCMC values and PTPE values**

12B.21 CRC ~~3X-3L~~ specifies that the UCMC value for ENWL 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 zero. It also specifies that provisional and final UCMC values will be directed by the Authority by 30 November in the relevant Regulatory Year.

#### **Determination of revised PCFM Variable Values and PTPE values**

12B.22 On or before 31 October ~~2019~~in any regulatory year, Ofgem will check to see whether a provisional or final determination of relevant adjustments has been made in respect of Moorside Costs that change the level of allowed expenditure for the licensee (provisionally or finally) and that has not previously been taken fully into account in the determination of revisions to UCMC values or 'Non-controllable opex (Exit Charges)' for the Regulatory Year or Years concerned.

12B.23 If the provisional or final determination of UCMC values has not previously been taken into account, the Authority will determine that the UCMC value 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.

12B.24 If the determination of revised PTPE values has not previously been taken into account, the Authority will determine that the 'Non-controllable opex (Exit Charges)' values in row 263 of the 'ENWL' tab in PCFM for the Regulatory Year or Years concerned is to be revised so that it equals the revised total amount (in 2012/13 prices) specified in the relevant adjustment determination.

#### **Notification and direction of revised UCMC values**

12B.25 The Authority will give Notice of any provisional or final revisions to UCMC values (including tax treatment within the PCFM) and PTPE values that it proposes to

direct by 15 November in any 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:

- (a) A provisional or final revised UCMC values **or PTPE values** determination has been made in accordance with Part B of CRC ~~3X3L~~, which cross refers to this chapter of this handbook; and
- (b) the licensee has 14 days from the date of the Notice in which to make any representations concerning the proposed PCFM Variable Value revisions.

12B.26 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.

12B.27 The Authority will only direct PCFM Variable Value revisions for uncertain cost activities in accordance with the provisions of CRC ~~3F3L~~. 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 UCMC values**

12B.28 If the procedures set out in CRC ~~3X-3L~~ and this chapter call for the Authority to direct revised PCFM Variable Values for one or more uncertain cost categories by 30 November in a given Regulatory Year 2019, and the Authority does not make such a direction, then CRC 3X 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

### **Effects of provisional and final revised UCMC values **and PTPE values****

12B.29 The Authority may, for a particular Annual Iteration Process, need to direct the use of a revised UCMC value for one or more PCFM Years preceding the one which equates to Relevant Year t.

12B.30 In such a case, any incremental changes to base revenue figures for those earlier PCFM Years calculated under the latest 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 Relevant 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.



## Part 3

# Legacy price control adjustment methodologies

## 13. Legacy price control financial adjustments overview

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### Section 1 - Introduction

13.1 This chapter introduces the methodologies contained in chapters 14, 15 and 16. These methodologies are used to determine revisions to PCFM Variable Values for the licensee associated with legacy price control financial adjustments.

13.2 The CRC that provides for legacy price control adjustments is CRC 3A (Legacy price control adjustments).

13.3 Legacy price control adjustments can arise with respect to:

- (a) activities carried out by the licensee;
- (b) incentivised performance by the licensee; and
- (c) costs or expenditure incurred by the licensee,

relating to Regulatory Years prior to Regulatory Year 2015/16 (the "legacy period"). Adjustments may be necessary where it was not possible to finalise values used in the calculation of the licensee's Opening Base Revenue Allowances either because complete data was not available in time, or because reviews, proposals or determinations were outstanding.

13.4 Legacy price control adjustments are divided into the following three categories, listed below with their associated PCFM Variable Values:

- (i) adjustments to opening tax pool balances – LTPG, LTPS, LTPD and LTPC values (see chapter 14);
- (ii) scheme-specific legacy price control adjustments to revenue allowances and legacy adjustments to RAV additions - OLREV and OLRAV values (see chapter 15); and
- (iii) adjustments to revenue allowances under the DPCR5 RAV Rolling Incentive mechanism - RIREV values (see chapter 16).

13.5 Revisions to the PCFM Variable Values set out in paragraph 13.4 affect the calculation of the value for MODt for the licensee under the Annual Iteration Process in the following ways:

- adjustments to opening tax pool balances are applied in the calculation of tax liability allowances;
- adjustments to RAV additions affect RAV balances<sup>31</sup> and give rise to adjusted return on RAV and depreciation amounts; and

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<sup>31</sup> The RAV balance in the PCFM as at 1 April 2015 will have been determined at the time of final determinations for the RIIO-ED1 price control.

- adjustments to revenue allowances (under scheme-specific legacy price control adjustments and the DPCR5 RAV Rolling Incentive mechanism) affect Fast Money amounts for the licensee, with adjustments profiled across the Price Control Period to mitigate allowed revenue volatility that might feed through to charges.

13.6 Opening LTPG, LTPS, LTPD and LTPC values for the licensee are set at zero because they relate to incremental changes to net tax pool additions that were taken into account in the calculation of Opening Base Revenue Allowances for the licensee.

13.7 Opening OLREV, OLRAV and RIREV values for the licensee are also set at zero because, in each case, they represent incremental changes to the values that were used in the calculation of the licensee's Opening Base Revenue Allowances. References in this paragraph to opening values for OLREV, OLRAV and RIREV mean the values in the PCFM Variable Values Table for the licensee as at 1 April 2015, before the direction of any revisions by the Authority.

13.8 The methodologies provide for the PCFM Variable Values to be revised as necessary during the Price Control Period. However, it is expected that legacy adjustments will be completed after-as part of the first four Annual Iteration Processes during the Price Control Period.

13.9 Where it is necessary to revise a PCFM Variable Value on more than one occasion, the effects of the further revisions will include a Time Value of Money Adjustment and will not affect any previously directed values of the term MOD.

13.10 Notice of any proposed revisions to the PCFM Variable Values referred to in this chapter will be given in accordance with the provisions of Part F of CRC3A. Any direction of revised OLREV and RIREV values will include a statement of the individual adjustment values used in their determination (see Tables 1 and 2 in CRC 3A).

13.11 Revised LTPG, LTPS, LTPD and LTPC values will be directed in nominal prices (see paragraphs 14.12, 14.18 and 14.24).

13.12 Revised OLREV, OLRAV and RIREV values will be directed in 2012/13 prices, consistent with the 2012/13 price base used in the PCFM.

### **Determination of revised OLREV, OLRAV and RIREV values**

13.13 Revised OLREV, OLRAV and RIREV values for the licensee will be determined under the methodologies set out in chapters 15 and 16 of this handbook. The methodologies are set out in sections 2 and 3 of chapter 15 (for OLREV and OLRAV values) and section 2 of chapter 16 (for RIREV values). The methodologies address, as applicable:

- the Regulatory Years in the legacy period that are covered;
- the use of outturn values reported by the licensee in calculations;
- the schemes and mechanisms under which:
  - expenditure allowances for the licensee can be varied; and

- inefficient actual expenditure by the licensee can be disallowed.

13.14 Each of the methodologies set out in chapters 15 and 16 is consistent with the underlying DPCR5 Price Control provision.

13.15 Where applicable, adjustment value calculations take account of provisional adjustments that were included in the calculation of Opening Base Revenue Allowances for the licensee. Further information in this respect, where applicable, is included in the methodologies contained in chapters 15 and 16.

13.16 The methodologies set out in chapters 15 and 16 are diverse in detail, but have the following in common:

- (i) They refer to and are consistent with relevant price control decisions by the Authority relating to the adjustment values in question (and reference documents are set out at the start of each methodology).
- (ii) They refer to and are consistent with any relevant content in the ED1 Final Determination for the licensee.
- (iii) They provide for the calculation of a range of adjustment values that take into account:
  - the overall adjustments applicable to the licensee; and
  - any provisional adjustments included in the calculation of the licensee's Opening Base Revenue Allowances.

## 14. Legacy tax pool balances – financial adjustment methodologies

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### Reference documents

1. [\[DPCR5\] Electricity Distribution Price Control Review Final Proposals – Financial Methodologies](https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-%E2%80%93-financial-methodologies)  
<https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-%E2%80%93-financial-methodologies>
2. [\[DPCR5\] Electricity Distribution Price Control Review Final Proposals – Allowed Revenue Cost assessment](https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-allowed-revenue-cost-assessment)  
<https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-allowed-revenue-cost-assessment>
3. [\[DPCR5\] Electricity Distribution Price Control Cost, Volume and Revenue Reporting - Regulatory Instructions and Guidance](https://www.ofgem.gov.uk/ofgem-publications/46561/costandrevenue-reporting-rigv3clean1.pdf)  
<https://www.ofgem.gov.uk/ofgem-publications/46561/costandrevenue-reporting-rigv3clean1.pdf>

### Section 1 - Overview

14.1 The tax pool balances for the licensee contained in the ED1 Price Control Financial Model (PCFM) are used in the calculation of tax liability allowances. The three tax pools are:

- the general tax pool;
- the special rate tax pool; and
- the deferred revenue expenditure tax pool.

14.2 The general and special rate tax pools are pools within the meaning of the Capital Allowances Act 2001(CAA) relating respectively to items that are not long life (as defined in the CAA) and items that have an economic life of more than 25 years (as defined in the CAA). The deferred revenue expenditure tax pool is a tax pool provided for under case law<sup>32</sup> for assets which constitute a replacement (rather than an enhancement) of existing assets and which, prior to 1 April 2005, were treated as 100% tax deductible.

14.3 The opening tax pool balances for the general and special rate tax pools that were used in the calculation of Opening Base Revenue Allowances were derived using provisional values for overall Net Tax Pool Movements for Regulatory Years 2013/14 and 2014/15. The opening value of cumulative additions to the deferred revenue expenditure tax pool that was used in the calculation of Opening Base Revenue Allowances was based on provisional values for additions for Regulatory

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<sup>32</sup> (Threlfall v Jones [1993] 66TC77, Herbert Smith v Honour [1999] 72TC130).

Years 2013/14 and 2014/15. In order to take account of updated values in recalculated base revenue figures produced under the Annual Iteration Process, the Authority can propose and determine revisions to four PCFM Variable Values:

- LTPG values relating to the general tax pool;
- LTPS values relating to the special tax pool; and
- LTPD and LTPC values relating to the deferred revenue expenditure tax pool.

14.4 Each of the PCFM Variable Values referred to in paragraph 14.3 has an opening value of zero as at 1 April 2015, because each relates to an incremental change to the Net Tax Pool Movements that were taken into account in the calculation of Opening Base Revenue Allowances for the licensee.

14.5 There are two PCFM Variable Values associated with the deferred revenue expenditure tax pool because it is subject to 'straight line reduction', whereas the other two tax pools are subject to the 'reducing balance' approach. This requires an additional value to be included in calculations within the ED1 Price Control Financial Model (PCFM) because capital allowances under the straight-line method are calculated using actual spend in the legacy period meaning that both Net Tax Pool Movements and actual expenditure amounts need to be taken into account.

14.6 The PCFM Variable Values referred to in paragraph 14.3 are only contained in the columns for Regulatory Years 2013/14 and 2014/15 in the PCFM Variable Values Table for the licensee. These are the Regulatory Years for which provisional overall Net Tax Pool Movements were used in the modelling of Opening Base Revenue Allowances for the licensee. Inputting incremental changes to overall Net Tax Pool Movements in these Regulatory Year columns facilitates the recalculation of base revenue figures which in turn are used in the calculation of the term MOD under the Annual Iteration Process.

## Section 2 – Derivation of revised LTPG values

14.7 On or after 31 July 2015, Ofgem will refer to worksheet "F13 Tax CA Pools" ('worksheet F13') in the most recently submitted DPCR5 Financial Issues Data Tables submitted by the licensee in accordance with the DPCR5 Cost and Revenue Reporting RIGs (see reference document 3).

14.8 Ofgem will refer to the subsection of worksheet F13 headed "Plant Pool & others" within the section headed "Distribution (DUoS excluding IFI and LCNF capex)", and will obtain Net Tax Pool Movements figures for the general tax pool for Regulatory Years 2013/14 and 2014/15 by summing:

- the 'Net Additions in the year' values shown in row 78 for Regulatory Years 2013/14 and 2014/15;
- the amount of any revision to the closing balance at 31 March 2013 and 31 March 2014 shown in row 76; and
- the negative writing down allowance ('WDA') values shown in row 80 for Regulatory Years 2013/14 and 2014/15.

14.9 In the event that any change to the row numbering in worksheet F13 has been made, the row labels referred to in paragraph 14.8 will be determinative.

14.10 For the avoidance of doubt, any determination by the Authority of:

- a DPCR5 High Value Projects - failure to deliver outputs adjustment (see chapter 15); or
- a DPCR5 Network Output Measures - failure to deliver outputs adjustment (see chapter 16),

will not result in a change to the overall Net Tax Pool Movements figures.

14.11 Ofgem will then check to see whether the overall Net Tax Pool Movements figures derived under paragraph 14.8 for Regulatory Years 2013/14 and 2014/15 ['A'] are different to the "General pool capital allowance pre-RIIO movement forecast" figures for the equivalent Regulatory Years that are contained as fixed input values for the licensee at row [386352](#) of the Input worksheet in the PCFM ['B']. If either figure is different, then the Authority will determine that the LTPG value for the Regulatory Year concerned should be revised to equal ['A'] minus ['B'].

14.12 The Net Tax Pool Movements figures referred to in paragraph 14.11 are in nominal prices as reported by the licensee in the DPCR5 Financial Issues Data Tables. LTPG values will be determined and directed in the same nominal prices. This is an exception to the general rule that PCFM Variable Values representing financial values are determined and directed in the 2012/13 price base used in the PCFM. See also paragraphs 1.6 and 4.10 in relation to the use of values in nominal prices for tax related calculations.

### Section 3 – Derivation of revised LTPS values

14.13 On or after 31 July 2015, Ofgem will refer to worksheet "F13 Tax CA Pools" ('worksheet F13') in the most recently submitted DPCR5 Financial Issues Data Tables submitted by the licensee in accordance with the DPCR5 Cost and Revenue Reporting RIGs (see reference document 3).

14.14 Ofgem will refer to the subsection of worksheet F13 headed "~~Plant Pool & others~~ Long life assets (>25 yrs Pool)" within the section headed "Distribution (DUoS excluding IFI and LCNF capex)", and will obtain Net Tax Pool Movements figures for the special tax pool for Regulatory Years 2013/14 and 2014/15 by summing respectively:

- the 'Net Additions in the year' values shown in row 87 for Regulatory Years 2013/14 and 2014/15;
- the amount of any revision to the closing balance at 31 March 2013 and 31 March 14 shown in row 85; and
- the negative writing down allowance ('WDA') values shown in row 89 for Regulatory Years 2013/14 and 2014/15.

14.15 In the event that any change to the row numbering in worksheet F13 has been made, the row labels referred to in paragraph 14.14 will be determinative.

- 14.16 For the avoidance of doubt, any determination by the Authority of:
- a DPCR5 High Value Projects - failure to deliver outputs adjustment (see chapter 15); or
  - a DPCR5 Network Output Measures - failure to deliver outputs adjustment (see chapter 16),

will not result in a change to the overall Net Tax Pool Movements figures.

14.17 Ofgem will then check to see whether the overall Net Tax Pool Movements figures derived under paragraph 14.14 for Regulatory Years 2013/14 and 2014/15 ['C'] are different to the "Special Rate capital allowance pre-RIIO movement forecast" figures for the equivalent Regulatory Years that are contained as fixed input values for the licensee at row [390356](#) of the Input worksheet in the PCFM ['D']. If either figure is different, then the Authority will determine that the LTPS value for the Regulatory Year concerned should be revised to equal ['C'] minus ['D'].

14.18 The Net Tax Pool Movements figures referred to in paragraph 14.17 are in nominal prices as reported by the licensee in the DPCR5 Financial Issues Data Tables. LTPS values will be determined and directed in the same nominal prices. This is an exception to the general rule that PCFM Variable Values representing financial values are determined and directed in the 2012/13 price base used in the PCFM. See also paragraphs 1.6 and 4.10 in relation to the use of values in nominal prices for tax related calculations.

## Section 4 – Derivation of revised LTPD and LTPC values

14.19 On or after 31 July 2015, Ofgem will refer to worksheet "F13 Tax CA Pools" ('worksheet F13') in the most recently submitted DPCR5 Financial Issues Data Tables submitted by the licensee in accordance with the DPCR5 Cost and Revenue Reporting RIGs (see reference document 3).

14.20 Ofgem will refer to the subsection of worksheet F13 headed "Deferred revenue expenditure ("DRE")", within the section headed "Distribution (DUoS excluding IFI and LCNF capex)", and will obtain overall Net Tax Pool Movements figures for the deferred revenue expenditure tax pool for Regulatory Years 2013/14 and 2014/15 by summing respectively:

- the 'Net Additions in the year' values shown in row 96 for Regulatory Years 2013/14 and 2014/15;
- the amount of any 'Revisions' to the closing balance at 31 March 2013 and 31 March 14 shown in row 94; and
- the negative writing down allowance ('WDA') values shown in row 98 for Regulatory Years 2013/14 and 2014/15.

14.21 In the event that any change to the row numbering in worksheet F13 has been made, the row labels referred to in paragraph 14.20 will be determinative.

14.22 For the avoidance of doubt, any determination by the Authority of:

- a DPCR5 High Value Projects - failure to deliver outputs adjustment (see chapter 15); or



- a DPCR5 Network Output Measures - failure to deliver outputs adjustment (see chapter 16),

will not result in a change to the overall Net Tax Pool Movements figures.

14.23 Ofgem will then:

- (i) check to see whether the overall Net Tax Pool Movements values referred to in paragraph 14.20 for Regulatory Years 2013/14 and 2014/15 ['E'] are different to the "Deferred revenue expenditure pre-RIIIO movement forecast" figures for the equivalent Regulatory Years that are contained as fixed input values for the licensee at row ~~365~~ 394 of the Input worksheet in the PCFM ['F']. If either figure is different, then the Authority will determine that the LTPD value for the Regulatory Year concerned should be revised to equal ['E'] minus ['F']; and
- (ii) check to see whether the 'Net Additions in the year' and 'Revisions' figures referred to in paragraph 14.20 for Regulatory Years 2013/14 and 2014/15 ['G'] are different to the "DRE: Gross capex forecast" figures for the equivalent Regulatory Years that are contained as fixed input values for the licensee at row ~~364-398~~ of the Input worksheet in the PCFM ['H']. If either figure is different, then the Authority will determine that the LTTPC value for the Regulatory Year concerned should be revised to equal ['G'] minus ['H'].

14.24 The figures referred to in paragraph 14.23 are in nominal prices as reported by the licensee in the DPCR5 Financial Issues Data Tables. LTPD and LTTPC values will be determined and directed in the same nominal prices. This is an exception to the general rule that PCFM Variable Values representing financial values are determined and directed in the 2012/13 price base used in the PCFM. See also paragraphs 1.6 and 4.10 in relation to the use of values in nominal prices for tax related calculations.

## **Section 5 – Determination and direction of revisions to LTPG, LTTPS, LTPD and LTTPC values**

14.25 The information needed to derive provisional revisions to LTPG, LTTPS, LTPD and LTTPC values for the licensee is due to be reported by the licensee in accordance with the deadline set in SLC46. The Authority will complete a review of the reported values by 31 October 2015 and, subject to paragraph 14.26, will use the values to determine revised LTPG, LTTPS, LTPD and LTTPC values for the licensee by 30 November 2015.

14.26 Subject to paragraphs 14.27 and 14.28, the Authority will determine further revisions to LTPG, LTTPS, LTPD and LTTPC values for the licensee if, with respect to the information referred to in paragraph 14.25:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality it had attached to that information with regard to a possible restatement requirement (see also paragraph 1.17 in chapter 1); or

- (b) the licensee is required, under any provision of the licence to restate any of that information.

14.27 Further revisions to LTPG, LTPS, LTPD and LTTPC values for the licensee of the type referred to in paragraph 14.26 may be determined by the Authority:

- (a) by 30 November 2016; and
- (b) by 30 November 2017.

14.28 No further revisions to LTPG, LTPS, LTPD and LTTPC values for the licensee will be determined after 30 November 2017, but this is without prejudice to any requirement for the licensee to restate the information referred to in paragraph 14.25 for any other purpose.

14.29 Paragraph 3A.31 of CRC 3A requires the Authority to give the licensee at least 14 days' Notice setting out any proposed revisions to LTPG, LTPS, LTPD, and LTTPC values that it has determined, before directing the revisions. This means that the Authority will give notice to the licensee of any revisions that it has determined by 15 November in the Regulatory Year t-1 concerned. 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.

14.30 Having complied with the Notice requirements, the Authority will direct any required revisions to LTPG, LTPS, LTPD and LTTPC values by 30 November in each applicable Regulatory Year t-1.

*Delay in direction of revised PCFM Variable Values*

14.31 If, for any reason, the Authority does not give a required direction of a revision to LTPG, LTPS, LTPD and LTTPC values by 30 November in an applicable Regulatory Year t-1, CRC 3A 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 CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

## 15. Legacy price control adjustments – financial methodologies

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### Reference documents

1. [\[DPCR5\] Electricity Distribution Price Control Review Final Proposals – Financial Methodologies](#)  
<https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-%E2%80%93-financial-methodologies>
2. [Decision letter on the pension deficit allocation methodology applicable to our funding in price controls of network operators’ pension deficits](#)  
<https://www.ofgem.gov.uk/publications-and-updates/decision-letter-pension-deficit-allocation-methodology-applicable-our-funding-price-controls-network-operators%E2%80%99-pension-deficits.?docid=149&refer=Networks>
3. [Energy Network Operators' Price Control Pension Costs - Regulatory Instructions and Guidance: Triennial Pension Reporting Pack supplement including pension deficit allocation methodology](#)  
<https://www.ofgem.gov.uk/ofgem-publications/42761/nwo-triennial-pension-rigs-supplements-v1.0-12apr13.pdf>
4. [Strategy decision for the RIIO-ED1 electricity distribution price control - Financial issues](#)  
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## Section 1 – Overview

- 15.1 This chapter contains the methodologies for determining:
  - (a) the legacy price control adjustments to revenue allowances set out in Table 1 in CRC3A (Legacy price control adjustments) and revisions to the associated PCFM Variable Value (the OLREV value); and
  - (b) legacy adjustments to RAV additions and revisions to the associated PCFM Variable Value (the OLRAV value),for the licensee.
- 15.2 The methodologies referred to in paragraph 15.1 take into account any provisional adjustments that were included in the determination of the licensee’s Opening Base Revenue Allowances.

## Section 2 – Determination of legacy adjustments to revenue allowances (other than those associated with the DPCR5 RAV Rolling Incentive mechanism) and revisions to the OLREV value

- 15.3 This section sets out the methodologies for determining:
- (a) the legacy price control adjustments to revenue allowances set out in Table 1 in CRC3A; and
  - (b) revisions to the PCFM Variable Value for legacy adjustments to revenue allowances (the OLREV value).

15.4 The adjustments referred to in paragraph 15.3(a) are set out in Table 1 in CRC3A which is reproduced below. The methodologies in subsections (i) to (xi) of this section set out the key features and principles of the individual adjustment schemes but they do not attempt to reproduce all of the detailed criteria contained in relevant DPCR5 Price Control decisions. Therefore, reference is made to the Authority's previous price control decisions where appropriate.

**Table 15.1 - Table 1 in CRC3A - Adjustments comprising the OLREV value**

<b>Adjustment</b>	<b>Section of chapter 15 of the ED1 Price Control Financial Handbook containing methodology</b>
DPCR5 Pension adjustment	Section 2 (i)
DPCR5 Tax adjustment	Section 2 (ii)
DPCR5 Distributed Generation adjustment	Section 2 (iii)
DPCR5 DUoS Bad Debts adjustment	Section 2 (iv)
DPCR5 Traffic Management Act Permit Costs adjustment	Section 2 (v)
DPCR5 Undergrounding and Worst Served Customer Improvements adjustment	Section 2 (vi)
DPCR5 Load Related Re-opener - adjustment resulting from revised allowance levels	Section 2 (vii)
DPCR5 High Volume Connections Volume Driver - adjustment resulting from revised allowance levels	Section 2 (viii)
DPCR5 High Value Projects Re-opener - adjustment resulting from revised allowance	Section 2 (ix)

levels	
DPCR5 Enhanced Physical Site Security and Black Start - adjustment resulting from revised allowance levels	Section 2 (x)
DPCR5 Shetland adjustment	Section 2 (xi)

15.5 The DPCR5 Shetland adjustment is only relevant to SSEH<sub>1</sub> and F for all other licensees the value of this adjustment is zero.

### i) DPCR5 Pension adjustment

#### References:

- i. Chapter 10 of reference document 1 specified at the start of this chapter.
- ii. Reference document 2 specified at the start of this chapter.
- iii. Reference document 3 specified at the start of this chapter.
- iv. Chapter 6 and Appendix 6 of Reference document 4 specified at the start of this chapter.
- v. Reference document 5 specified at the start of this chapter.

#### Overview

15.6 The term DPCR5 Pension adjustment means the adjustment described in this subsection, the basis for which is set out in Chapter 10 and Table 10.8 in reference document 1.

15.7 This subsection sets out the methodology for determining the DPCR5 Pension adjustment to allowed revenue for the licensee which is comprised of:

- (a) an adjustment relating to DPCR5 ongoing pension expenditure; and
- (b) an adjustment relating to DPCR5 Pension Protection Fund Levy expenditure.

#### Adjustment relating to DPCR5 ongoing pension expenditure

15.8 DPCR5 ongoing pension expenditure consists of:

- (a) the funding of defined benefit pension schemes in respect of pensionable service that took place on or after 1 April 2010;
- (b) the funding of defined contribution benefit schemes and Personal Accounts associated with Qualifying Workplace Pension Schemes under the provisions of the Pensions Act 2008; and
- (c) pension administration costs.

15.9 The overall adjustment relating to DPCR5 ongoing pension expenditure applies incentivised true-up rates to any underspend or overspend by the licensee against the allowances it was given at the outset of the DPCR5 Price Control period. It comprises an adjustment to the licensee's revenue allowances and an adjustment to the licensee's RAV additions, the latter also being used in determining revisions to the PCFM Variable Values for legacy adjustments to RAV additions (see section 3 of this chapter).

15.10 The following steps will be carried out to calculate the adjustment relating to DPCR5 ongoing pension expenditure:

- (i) Expenditure allowances for each Regulatory Year in DPCR5 will be obtained and restated in 2012/13 prices.
- (ii) Actual expenditure amounts for each Regulatory Year in DPCR5 will be obtained and restated in 2012/13 prices.
- (iii) The actual expenditure amounts obtained at step (ii) will be split into:
  - Slow Money components;
  - Fast Money components (excluding business support and non-operational capex); and
  - business support and non-operational capex components, and totalled for the DPCR5 Price Control.
- (iv) The total amount of over or under spend will be calculated ~~and expressed as an absolute value~~ in 2012/13 prices.
- (v) The relevant incentive rate will be applied the value calculated at step(iv) to produce a value that is:
  - 80% of any over spend; or
  - 50% of any under spend.
- (vi) The value obtained under step (v) will be allocated back to the components referred to in step (iii), with a percentage of the total value attributed to each Regulatory Year in DPCR5 that is equal to the percentage of the equivalent component of actual expenditure for the Regulatory Year concerned.
- (vii) The following values will be calculated, based on the allocation referred to in step (vi):
  - (a) an amount of Fast Money;
  - (b) an amount of depreciation (being annual values calculated as the applicable value divided by 20); and
  - (c) an amount of return at WACC for DPCR5 (applied to the NNRRB),

for each Regulatory Year in DPCR5 in 2012/13 prices.

The amounts referred to in substeps (b) and (c) will be calculated on the basis of notional RAV balance impacts attributable to the over spend or under spend.

- (viii) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (vii) to put them on a common 2015/16 time value basis and the values will then be totalled.

If the amount referred to in step (iv) is an under spend, then the total value will be a negative amount.

If the amount referred to in step (iv) is an over spend, then the total value will be a positive amount.

- (ix) An adjustment for the impact of corporation tax will be applied to the total obtained under step (viii), calculated as the total obtained under step (viii) multiplied by -1 and then multiplied by the corporation tax rate used in the modelling of DPCR5 Revenue Allowances for the licensee which is 28%.

If the total obtained under step (viii) is a positive amount, then the adjustment for the impact of corporation tax will involve the addition of a negative value.

If the total obtained under step (viii) is a negative amount, then the adjustment for the impact of corporation tax will involve the addition of a positive value.

- (x) Any provisional adjustment relating to the licensee's DPCR5 ongoing pension expenditure that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (ix).

15.11 The value obtained at step (x) in paragraph 15.10 is the adjustment relating to DPCR5 ongoing pension expenditure for the licensee.

15.12 In order to perform the steps set out in paragraph 15.10 the Authority will require the licensee's actual DPCR5 ongoing pension expenditure levels, analysed into:

- (a) amounts admissible to the licensee's RAV;
- (b) Fast Money components (excluding business support and non-operational capex); and
- (b) expenditure reportable by the licensee as business support and non-operational capex,

under the terms of the DPCR5 Price Control.

These expenditure levels are due to be reported by the licensee by 31 July 2015 under applicable Regulatory Instructions and Guidance and will be reviewed by the Authority.

*Adjustment to the licensee's RAV additions (see also section 3 of this chapter)*

15.13 If the ~~absolute~~-value obtained under step (iv) in paragraph 15.10 represents an under spend amount, then the amount of the overall notional RAV balance impact referred to in step (viii) in paragraph 15.10, less any provisional amount that was included in the calculation of the licensee's Opening Base Revenue Allowances will be added to the licensee's RAV additions. This involves multiplying the negative RAV balance impact by -1 to achieve a positive number to add to the



RAV. This adjustment is required to ensure that the revenue adjustment calculated under paragraph 15.10, and this addition to the licensee's RAV, taken together, achieve the incentive effect due as a result of an underspend.

15.14 If the value obtained under step (iv) in paragraph 15.10 represents an over spend amount, then 25% of the overall notional RAV balance impact referred to in step (viii) in paragraph 15.10, less any provisional amount that was included in the calculation of the licensee's Opening Base Revenue Allowances. will be deducted from the licensee's RAV additions. This involves multiplying the positive RAV balance impact by -0.25 to achieve a negative number to be added to the RAV. This adjustment is required to ensure that the revenue adjustment calculated under paragraph 15.10, and this deduction from additions to the licensee's RAV, taken together, achieve the incentive effect due as a result of an overspend.

### **Adjustment relating to DPCR5 Pension Protection Fund Levy expenditure**

15.15 The adjustment relating to DPCR5 Pension Protection Fund Levy expenditure consists of:

- (a) an amount of Fast Money;
- (b) an amount of depreciation (being annual values calculated as the applicable value divided by 20); and
- (c) an amount of return, at WACC for DPCR5,

relating to the differences between the licensee's actual DPCR5 Pension Protection Fund Levy expenditure, and the expenditure allowances it was given at the outset of the DPCR5 Price Control period.

15.16 The following steps are carried out to calculate the adjustment relating to DPCR5 Pension Protection Fund Levy expenditure:

- (i) Expenditure allowances for each Regulatory Year in DPCR5 will be obtained and restated in 2012/13 prices.
- (ii) An amount of depreciation (being annual values calculated as the applicable value divided by 20) associated with the expenditure allowances referred to in step (i) will be calculated for each Regulatory Year in DPCR5.
- (iii) An amount of return associated with the expenditure allowances referred to in step (i) will be calculated for each Regulatory Year in DPCR5 at WACC for DPCR5 (applied to the NNRRB).
- (iv) The amounts calculated under steps (ii) and (iii) will be added to the Fast Money amounts attributable to the expenditure allowances referred to in step (i) for each Regulatory Year in DPCR5.
- (v) Actual expenditure amounts will be obtained for each Regulatory Year in DPCR5 and restated in 2012/13 prices.
- (vi) Any exceptional adjustment amounts, in 2012/13 prices, will be deducted from the actual expenditure amounts referred to in step (v) – see paragraphs 15.21 to 15.23.
- (vii) An amount of depreciation (being annual values calculated as the applicable value divided by 20) associated with the actual expenditure

amounts referred to in step (v) will be calculated for each Regulatory Year in DPCR5.

- (viii) An amount of return associated with the actual expenditure amounts referred to in step (v), or as applicable (vi), will be calculated for each Regulatory Year in DPCR5 at the WACC for DPCR5.
- (ix) The amounts calculated under steps (vii) and (viii) will be added to the Fast Money amounts attributable to the actual expenditure amounts referred to in step (v) for each Regulatory Year in DPCR5.
- (x) For each Regulatory Year of DPCR5, the total obtained at step (iv) will be deducted from the total obtained at step (ix).
- (xi) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (x) to put them on a common 2015/16 time value basis and the values will then be totalled.
- (xii) An adjustment for the impact of corporation tax will be added to the total obtained under step (xi), calculated as the total obtained under step (xi) multiplied by -1 and then multiplied by the corporation tax rate used in the modelling of allowed revenues for the licensee for DPCR5.
- (xiii) Any provisional adjustment relating to the licensee's DPCR5 Pension Protection Fund Levy expenditure that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (xii).

15.17 The value obtained at step (xiii) in paragraph 15.16 is the adjustment relating to DPCR5 Pension Protection Fund Levy expenditure for the licensee.

15.18 In order to perform the steps set out in paragraphs 15.16, the Authority will require the licensee's actual DPCR5 Pension Protection Fund Levy expenditure levels, analysed into:

- (a) network investment & closely associated indirect costs; and
- (b) business support and non-operational capex,

as expenditure reported by the licensee in accordance with applicable Regulatory Instructions and Guidance. These expenditure levels are due to be reported by the licensee by 31 July 2015 under applicable Regulatory Instructions and Guidance and will be reviewed by the Authority.

15.19 The adjustment relating to DPCR5 Pension Protection Fund Levy expenditure does not involve an adjustment to the licensee's RAV additions unless there has been an exceptional deduction from the licensee's actual expenditure amounts (see steps (v) and (vi) in paragraph 15.16 and paragraphs 15.21 to 15.23.

#### *Exceptional adjustments to DPCR5 Pension Protection Fund Levy expenditure*

15.20 There are two cases in which the Authority can apply deductions to the licensee's DPCR5 Pension Protection Fund Levy expenditure values for the purpose of legacy price control adjustments which are set out in paragraphs 15.21 and 15.22.

15.21 The licensee was subject to an annual cap of £0.1m on the fixed element of DPCR5 Pension Protection Fund Levy and annual cap of £0.4m on the risk based element (in both cases in 2007/08 prices) – see paragraph 10.27 in reference document 1 specified at the start of this chapter. If the licensee’s reported expenditure (in 2007/08 prices) breaches either of these caps then the Authority will apply a deduction equivalent to the excess amount for the Regulatory Year concerned.

15.22 If the Authority determines that the licensee has incurred excessive DPCR5 Pension Protection Fund Levy costs as a result of inadequately managing the risk factors taken into account by the Pension Protection Fund in setting the levy, then the Authority will apply a deduction, for the Regulatory Year concerned, equivalent to the amount it determines to be attributable to the inadequate risk management. Before determining that a deduction should be applied in respect of the licensee’s management of risk factors, the Authority will consult with the licensee and consider any representations made by the licensee in response to that consultation.

15.23 If any deductions are applied to the licensee’s DPCR5 Pension Protection Fund Levy expenditure in accordance with paragraph 15.21 or paragraph 15.22, then an amount equivalent to a notional overall RAV balance impact attributable to the deductions, less any provisional amount that was included in the calculation of the licensee’s Opening Base Revenue Allowances will be deducted from the licensee’s RAV additions.

### **Determination of DPCR5 Pension adjustment value**

15.24 The Authority will sum the adjustment relating to DPCR5 ongoing pension expenditure (see paragraph 15.11) and the adjustment relating to DPCR5 Pension Protection Fund Levy expenditure (see paragraph 15.17) to determine the DPCR5 Pension adjustment value for the licensee.

15.25 The values referred to in paragraphs 15.12 and 15.18 are due to be reported by the licensee to the Authority by 31 July 2015. The Authority will complete a review of the reported values by 31 October 2015 and, subject to paragraph 15.26, will use the values to determine the DPCR5 Pension adjustment value for the licensee by 30 November 2015.

15.26 Subject to paragraphs 15.27 and 15.28, the Authority will determine a revised DPCR5 Pension adjustment value for the licensee if, with respect to the values referred to in paragraph 15.25:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality it had attached to those values with regard to a possible restatement requirement or in relation to the provision set out in paragraph 15.22, (see also paragraph 1.17 in chapter 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

15.27 A revised DPCR5 Pension adjustment value for the licensee may be determined by the Authority:

- (a) by 30 November 2016 for the purpose of determining the value of OLREV by 30 November 2016; and
- (b) by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017.

15.28 No further revisions to the DPCR5 Pension adjustment value for the licensee will be determined after 30 November 2017 for the purpose of determining a revised value of OLREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph 15.25 for any other purpose.

## ii) DPCR5 Tax adjustment

### *References:*

- i. Chapter 4 of reference document 9 specified at the start of this chapter
- ii. Chapter 7 of reference document 5 specified at the start of this chapter
- iii. Reference document 10 specified at the start of this chapter

### **Overview**

15.29 This subsection sets out the methodology for determining the DPCR5 Tax adjustment to allowed revenue for the licensee which is comprised of:

- (a) an adjustment relating to the licensee's Gearing levels and debt interest costs during the DPCR5 Price Control period; and
- (b) an adjustment relating to the changed regulatory basis for setting tax liability allowances at the end of the DPCR5 Price Control period.

15.30 The term DPCR5 Tax Claw-back adjustment means the adjustment described in this subsection and, with respect to the adjustment relating to Gearing levels and debt interest costs, whose basis is set out in chapter 4 of reference document 8 and in reference document 9.

~~15.30 The term adjustment means the adjustment described in this subsection and, DPCR5 Tax with respect to the adjustment relating to Gearing levels and debt interest costs, whose basis is set out in chapter 4 of reference document 9 and in reference document 10.~~

### **Adjustment relating to Gearing levels and debt interest costs**

15.31 The DPCR5 Price Control included a tax claw-back mechanism applicable where, in any Regulatory Year:

- the licensee's actual Gearing exceeded the Gearing level assumed in modelling the licensee's DPCR5 Revenue Allowances; and
- the licensee's interest costs exceeded the interest costs assumed in modelling the licensee's DPCR5 Revenue Allowances,

meaning that the licensee would have had lower tax liabilities than those for which allowances had been given because of the tax shield effect of interest payments.

15.32 The following steps are carried out to calculate the adjustment relating to the licensee's Gearing levels and debt interest costs:

- (i) The licensee's finalised RAV balances (taking into account the finalised RAV additions referred to in paragraph ~~15.279~~~~15.280~~) as at the end of each Regulatory Year in DPCR5, in nominal prices, will be obtained.
- (ii) The figures referred to in step (i) will be inflated to year end nominal prices as at 31 March at the end of each Regulatory Year concerned by multiplying them by the March/April RPI Factor for that Regulatory Year<sup>33</sup>.
- (iii) The licensee's overall net debt balances as at 31 March for each Regulatory Year in DPCR5, in nominal prices, will be obtained.
- (iv) Amounts outside of the definition of applicable net debt set out in reference document 10 will be deducted from the values obtained under step (iii).
- (v) The licensee's actual Gearing will be calculated for each Regulatory Year in DPCR5 by dividing each of the values obtained at step (iv) by the RAV value for the same Regulatory Year obtained at step (ii).
- (vi) The licensee's actual interest payment total for each Regulatory Year in DPCR5 will be obtained, in nominal prices, in accordance with the definition set out in reference document 10.
- (vii) Any interest received by the licensee during each Regulatory Year of DPCR5 that falls within the definition referred to in step (vi) will be deducted from the interest payment total for the Regulatory Year concerned.
- (viii) The interest costs assumed in modelling DPCR5 Revenue Allowances for the licensee will be obtained, in nominal prices, for each Regulatory Year in DPCR5.
- (ix) The interest costs obtained at step (viii) will be adjusted so that they reflect actual RPI values rather than the assumed RPI values used in modelling DPCR5 Revenue Allowances for the licensee.
- (x) The adjusted modelled interest cost values calculated at row (ix) will be deducted from the net interest payment values calculated at step (vii) for each Regulatory Year in DPCR5.
- (xi) For each Regulatory Year in DPCR5 a check will be made to see whether both of the following tests are passed:  

The first test is passed if the licensee's actual Gearing calculated at step (v) is higher than the Gearing level assumed in modelling the licensee's DPCR5 Revenue Allowances.

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<sup>33</sup> See Glossary

The second test is passed if the value calculated at step (x) is a positive value.

- (xii) If, for any Regulatory Year in DPCR5, either of the tests in step (xi) **has** failed, then no adjustment relating to Gearing levels and debt interest costs will apply in respect of that year.
- (xiii) If, for any Regulatory Year in DPCR5, both of the tests in step (xi) are passed, then the value calculated at step (x) for the Regulatory Year concerned will be multiplied by the corporation tax rate used in DPCR5 modelling to calculate the licensee's tax benefit in nominal prices.
- (xiv) Any values for Regulatory Years in DPCR5 calculated at step (xiii) will be restated in 2012/13 prices.
- (xv) Any values restated at step (xiv) will be summed to obtain a total adjustment value.
- (xvi) Any provisional adjustment relating to Gearing levels and debt interest costs for the licensee that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the adjustment value calculated at step (xv).

15.33 Subject to step (xii), the value obtained at step (xvi) in paragraph 15.32 is the adjustment relating to Gearing levels and debt interest costs for the licensee.

15.34 In order to perform the steps set out in paragraph 15.32, the Authority will require the following information from the licensee:

- RAV balances as at the end of each Regulatory Year in DPCR5, in nominal prices - see step (i);
- net debt balances as at 31 March for each Regulatory Year in DPCR5 - see steps (iii) and (iv); and
- actual interest payment and interest received totals for each Regulatory Year in DPCR5.

These values will be reported by the licensee under applicable Regulatory Instructions and Guidance and will be reviewed by the Authority.

15.35 The adjustment relating to Gearing levels and debt interest costs does not involve an adjustment to the licensee's RAV additions.

### **Adjustment relating to the changed basis for setting tax liability allowances**

15.36 Up until (and including) Regulatory Year 2012/13 in the DPCR5 Price Control, the licensee was given tax liability allowances based on the actual payments it would be required to make to HM Revenue and Customs in the Regulatory Year concerned under relevant tax legislation (the 'old basis'). However, for Regulatory Years after 2012/13, the basis for setting tax liability allowances was changed so that they were based on the modelled tax charge applicable to the licensee for the Regulatory Year concerned (the 'new basis').

15.37 Because there was no Annual Iteration Process or other mechanism to update tax liability allowances during DPCR5, an adjustment in respect of Regulatory Years 2013/14 and 2014/15 is required. The overall adjustment process involves:

- (a) modelling the licensee's tax liability allowances for 2013/14 and 2014/15 on the new basis;
- (b) determining relevant amounts foregone by the licensee because the allowances it actually received during DPCR5 were set on the old basis;
- (c) checking that the amounts at (b) reflect modelled tax liabilities (as opposed to tax losses);
- (d) applying a materiality test to the foregone amounts referred to at (b) set at 120% of the modelled tax liability allowance for Regulatory Year 2015/16 for the licensee;
- (e) determining, if applicable, the value of the foregone amounts that is in excess of the modelled tax liability allowance for Regulatory Year 2015/16 for the licensee; and
- (f) applying, if applicable, a grossing up adjustment in respect of the tax on tax allowance effect.

15.38 The following steps are carried out to calculate the adjustment relating to the changed regulatory basis for setting tax liability allowances at the end of the DPCR5 Price Control period:

- (i) The licensee's tax liability allowances for Regulatory Years 2013/14 and 2014/15, modelled in nominal prices on the new basis, will be obtained from the financial issues pack.
- (ii) The figures referred to in step (i) will be deflated to 2012/13 prices.
- (iii) The licensee's tax liability allowance for Regulatory Year 2013/14, that was modelled in nominal prices on the old basis will be obtained from the financial issues pack.
- (iv) The figure referred to in step (iii) will be deflated to 2012/13 prices.
- (v) The figure calculated at step (iv) will be deducted from the figure calculated at step (ii) for Regulatory Year 2013/14. This will provide a value for the amount of allowance foregone by the licensee in respect of Regulatory Year 2013/14.
- (vi) The licensee's tax liability allowance for Regulatory Year 2015/16, modelled in nominal prices on the new basis will be obtained from the ED1 Price Control Financial Model.
- (vii) The figure referred to in step (vi) will be deflated to 2012/13 prices.
- (viii) The figure calculated at step (vii) will be multiplied by 0.5 to provide a proxy value for the amount of allowance foregone by the licensee in respect of Regulatory Year 2014/15. The factor of 0.5 represents two quarters of a year.
- (ix) The three values calculated at steps (ii) and (vii) will be summed to check that there is a positive value representing an overall tax liability.
- (x) The values calculated at steps (v) and (viii) will be summed to calculate the total amount of allowance foregone by the licensee in respect of Regulatory Years 2013/14 and 2014/15.

- (xi) The materiality test value will be calculated as 120 percent of the value calculated at step (vii).
- (xii) If the value calculated at step (x) is greater than the materiality test value calculated at step (xi), then step (xiii) will be performed; otherwise the adjustment relating to the changed basis for setting tax liability allowances for the licensee is zero.
- (xiii) The value at step (vii) will be deducted from the value at step (x) to calculate the amount of allowance foregone by the licensee in respect of Regulatory Years 2013/14 and 2014/15 that is in excess of a threshold level equal to the licensee's tax liability allowance for Regulatory Year 2015/16 (in 2012/13 prices).
- (xiv) The value calculated at step (xiii) will be divided by a value that is itself calculated as one minus the corporation tax rate used in modelling the licensee's tax liability allowance for Regulatory Year 2014/15. This will gross up the value calculated at step (xiii) to apply the tax allowance on tax allowance factor.
- (xv) Any provisional adjustment for the licensee relating to the changed basis for setting tax liability allowances that was included in the calculation of the licensee's Opening base Revenue Allowances will be deducted from the value calculated at step (xiv).

15.39 Subject to step (xii), the value obtained at step (xv) in paragraph 15.38 is the adjustment relating to the changed regulatory basis for setting tax liability allowances for the licensee.

15.40 In order to perform the steps set out in paragraph 15.38, the Authority will require:

- the licensee's tax liability allowances for Regulatory Years 2013/14 and 2014/15, modelled in nominal prices on the new basis;
- the licensee's tax liability allowance for Regulatory Year 2013/14, modelled in nominal prices on the old basis; and
- the licensee's tax liability allowance for Regulatory Year 2015/16, modelled in nominal prices on the new basis.

15.41 These values will be reported by the licensee under applicable Regulatory Instructions and Guidance and will be reviewed by the Authority.

15.42 The adjustment relating to the changed basis for setting tax liability allowances does not involve an adjustment to the licensee's RAV additions.

### **Determination of DPCR5 Tax adjustment value**

15.43 The Authority will sum the adjustment relating to Gearing levels and debt interest costs (see paragraph 15.33) and the adjustment relating to the changed basis for setting tax liability allowances (see paragraph 15.39) to determine the DPCR5 Tax adjustment value for the licensee in 2012/13 prices.

15.44 As noted at paragraphs 15.34 and 15.40, the values required by the Authority to determine the DPCR5 Tax adjustment value for the licensee will be



reported by the licensee under applicable Regulatory Instructions and Guidance and will be reviewed by the Authority.

15.45 The values referred to in paragraph ~~15.44~~~~15.43~~ are due to be reported by the licensee to the Authority by 31 July 2015. The Authority will complete a review of the reported values by 31 October 2015 and, subject to paragraph ~~15.46~~~~15.45~~, will use the values to determine the DPCR5 Tax adjustment value for the licensee by 30 November 2015.

15.46 Subject to paragraphs ~~15.47~~~~15.46~~ and ~~15.48~~~~15.47~~, the Authority will determine a revised DPCR5 Tax adjustment value for the licensee if, with respect to the values referred to in paragraph ~~15.44~~~~15.43~~:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality it had attached to those values with regard to a possible restatement requirement (see also paragraph 1.17 in chapter 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

15.47 A revised DPCR5 Tax adjustment value for the licensee may be determined by the Authority:

- (a) by 30 November 2016 for the purpose of determining the value of OLREV by 30 November 2016; and
- (b) by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017.

15.48 No further revisions to the DPCR5 Tax adjustment value for the licensee will be determined after 30 November 2017 for the purpose of determining a revised value of OLREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~15.44~~~~15.43~~ for any other purpose.

### iii) DPCR5 Distributed Generation adjustment

#### *References:*

- i. Chapter 5 of reference document 1 specified at the start of this chapter
- ii. Reference document 5 specified at the start of this chapter
- iii. Chapter 3 of reference document 8 specified at the start of this chapter

#### **Overview**

15.49 This subsection sets out the methodology for determining the DPCR5 Distributed Generation adjustment to allowed revenue for the licensee.

15.50 The term DPCR5 Distributed Generation adjustment means the adjustment described in this subsection that relates to the remuneration and incentive mechanism for the connection of Distributed Generation (DG) capacity during DPCR5. The mechanism is set out in Chapter 5 in reference document 1 and

in Special Condition CRC 11 of the licence in the form it was in on 31 March 2015 ("CRC 11").

15.51 All outstanding adjustments relating to the remuneration and incentive mechanism for the connection of DG capacity in DPCR4 were included in the calculation of the licensee's Opening Base Revenue Allowances.

15.52 The DPCR5 DG incentive mechanism comprised:

- (a) a 5.6% rate of return on 80% of eligible capital expenditure for a period of 15 years from the year of expenditure;
- (b) an incentive payment of £1,000 per year (in 2007/08 prices) for each megawatt of connected capacity for a period of 15 years from the year of connection;
- (c) a cap and collar on the percentage return represented by the revenue streams derived from the items in subparagraphs (a) and (b), with
  - the cap set at 11.2 percent; and
  - the collar set at 3.6 percent;

and

- (d) an operation and maintenance allowance of £1,000 per year (in 2007/08 prices) for each megawatt of connected capacity for a period of 15 years from the year of connection.

15.53 The overall adjustment relating to DPCR5 Distributed Generation to allowed revenue for the licensee takes into account:

- the licensee's projected revenue entitlements out to Regulatory Year 2029/30 (being 15 years from the end of DPCR5);
- amounts that were included in the licensee's allowed revenue during DPCR5; and
- the cap and collar referred to in paragraph ~~15.52~~15.51(c).

15.54 The DPCR5 DG adjustment does not involve an adjustment to the licensee's RAV additions.

### **Calculation of the DPCR5 Distributed Generation adjustment value**

15.55 The following steps are carried out to calculate the adjustment relating to DPCR5 DG:

- (i) Total incentivised DG capacity for each Regulatory Year in DPCR5 will be obtained.
- (ii) Incentive payments will be calculated by multiplying the totals in step (i) by the incentive rate of £1,000 per megawatt in 2007/08 prices.
- (iii) The values obtained under step (ii) will be inflated into nominal prices.
- (iv) The nominal value incentive payments for Regulatory Years after 2014/15 will be calculated using an RPI indexation factor of 3.1% to uplift the incentive payment value in the final year of DPCR5. For

Regulatory Years from 2026/27 to 2029/30, the capacity total will be abated with respect to capacity for which the 15 year payment period has elapsed.

- (v) Use of System Capex amounts will be obtained for each Regulatory Year in DPCR5.
- (vi) The values obtained under step (v) will be inflated into nominal prices and totalled.
- (vii) The Use of System Capex subject to pass through for each regulatory Year in DPCR5 will be calculated by multiplying the values obtained in step (vi) by the pass through rate of 80%.
- (viii) Any Use of System Capex transferred to the licensee's RAV in accordance with Part K of CRC 11 will be deducted from the values obtained in step (vii).
- (ix) Rate of return payments on the Use of System Capex figures calculated at step (viii) will be projected for all Regulatory Years from 2010/11 to 2029/30 applying Time Value of Money Adjustments using the 5.6 percent rate of return referred to in paragraph ~~15.52~~15.51(a).
- (x) Allowed revenue streams in nominal prices will be calculated using the sum of rate of return payments as calculated in step (ix) and the total incentive payments calculated in steps (iii) and (iv).
- (xi) Internal Rates of Return (IRRs) will be calculated:
  - a. for the DPCR5 period; and
  - b. for the entire period from 1 April 2011 to 31 March 2030.
- (xii) The Internal Rates of Return calculated at step (xi) will be compared to the cap and collar referred to in paragraph ~~15.52~~15.51(c).
- (xiii) If the Internal Rate of Return referred to in step (xi)(b) is between the cap and collar percentages, then no adjustment under the cap or collar is applied.

If the Internal Rate of Return referred to at step (xi)(b) is lower than the collar rate of 3.6 percent then an adjustment will be made to the total allowed revenue streams referred to in step (x) such that the Internal Rate of Return matches the collar.

If the Internal Rate of Return at step (xi)(a) is above the cap rate of 11.2 percent, then an adjustment will be made to the total allowed revenue in regulatory year 2015/16 such that the Internal Rate of Return matches the cap.

If the Internal Rate of Return referred to in step (xi)(b) is above the cap rate of 11.2 percent, then an adjustment will be made to the total allowed revenue streams referred to in step (x) such that the Internal Rate of Return matches the cap.

If the total of Use of System Capex amounts values referred to at step (v) are zero, then the mechanism does not apply and the allowed revenue streams referred to in step (x) are set to zero.

- (xiv) Operational and maintenance allowances will be calculated by multiplying the totals in step (i) by the incentive rate of £1,000 per megawatt in 2007/08 prices.
- (xv) The values obtained under step (xiv) will be inflated into nominal prices.
- (xvi) The nominal value operational and maintenance allowances for Regulatory Years after 2014/15 will be calculated using an RPI indexation factor of 3.1% to uplift the operational and maintenance allowance value in the final year of DPCR5. For Regulatory Years from 2026/27 to 2029/30, the capacity total will be abated with respect to capacity for which the 15 year payment period has elapsed.
- (xvii) DG revenue for each Regulatory Year from 2015/16 to 2029/30 will be calculated by summing the value for each of those Regulatory Years included in the allowed revenue amounts obtained at steps (xiii) and (xvi).
- (xviii) The revenues amounts obtained at step (xvii) will be deflated to 2012/13 prices and then discounted to a single value for Regulatory Year 2015/16 using the Vanilla WACC percentage applicable to the licensee for Regulatory Year 2015/16.
- (xix) Any provisional adjustment relating to the DPCR5 remuneration and incentive mechanism for DG that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (xviii).

15.56 The value obtained at step (xix) in paragraph ~~15.55~~~~15.54~~ is the adjustment relating to DPCR5 DG adjustment values for the licensee.

15.57 In order to perform the steps set out in paragraphs ~~15.55~~~~15.54~~, the Authority will require the following information with respect to the licensee:

- (a) total incentivised DG capacity connected;
- (b) total eligible capital expenditure; and
- (c) eligible capital expenditure transferred to the licensee's RAV.

for each Regulatory Year of DPCR5.

These items will be reported by the licensee under applicable Regulatory Instructions and Guidance and will be reviewed by the Authority.

### **Determination of the DPCR5 Distributed Generation adjustment value**

15.58 The values referred to in paragraph ~~15.57~~~~15.56~~ are due to be reported by the licensee to the Authority by 31 July 2015. The Authority will complete a review of the reported values by 31 October 2015 and, subject to paragraph ~~15.59~~~~15.58~~, will use the values to determine the DPCR5 Distributed Generation adjustment value for the licensee by 30 November 2015.

15.59 Subject to paragraphs ~~15.60~~~~15.59~~ and ~~15.61~~~~15.60~~, the Authority will determine a revised DPCR5 Distributed Generation adjustment value for the licensee if, with respect to the values referred to in paragraph ~~15.58~~~~15.57~~:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality it had attached to those values with regard to a possible restatement requirement (see also paragraph 1.17 in chapter 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

15.60 A revised DPCR5 Distributed Generation adjustment value for the licensee may be determined by the Authority:

- (a) by 30 November 2016 for the purpose of determining the value of OLREV by 30 November 2016; and
- (b) by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017.

15.61 No further revisions to the DPCR5 Distributed Generation adjustment value for the licensee will be determined after 30 November 2017 for the purpose of determining a revised value of OLREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~15.58~~[15.57](#) for any other purpose.

#### **iv) DPCR5 DUoS Bad Debts adjustment**

##### *References:*

- i. Chapter 3 of reference document 1 specified at the start of this chapter
- ii. Reference document 5 specified at the start of this chapter
- iii. Reference document 11 specified at the start of this chapter

##### **Overview**

15.62 The term DPCR5 DUoS Bad Debts adjustment means the adjustment described in this subsection, the basis for which is set out in Chapter 3 in reference document 1.

15.63 The DPCR5 Price Control provided for bad debt costs in respect of distribution use of system (DUoS) charges, incurred by the licensee during the DPCR5 Price Control, to be reimbursed, subject to criteria set out in reference document 11.

15.64 This subsection sets out the methodology for determining the DPCR5 DUoS Bad Debts adjustment to allowed revenue for the licensee. The DPCR5 DUoS Bad Debts adjustment does not involve an adjustment to the licensee's RAV additions.

15.65 In order to determine the DPCR5 DUoS Bad Debts adjustment for the licensee the Authority will:

- (a) assess the eligible bad debt cost for the licensee for each Regulatory Year of DPCR5; and

- (b) calculate the adjustment to allowed revenue for the licensee arising from the eligible bad debt costs referred to in subparagraph (a).

### Determination of eligible bad debt cost

15.66 The following steps are carried out to determine eligible bad debt costs for the licensee for each Regulatory Year of DPCR5:

- (i) By 30 April 2015, the Authority will send the licensee an electronic claim form for DPCR5 DUoS Bad Debts in Microsoft Excel ® format, copies of which can be completed and returned by the licensee at any time up to 30 June 2018, with bad debt cost values stated in 2012/13 prices.
- (ii) By 31 August in each Regulatory Year from 2015/16 to 2018/19, the Authority will evaluate any completed claim forms received from the licensee against the criteria set out in reference document 11.

If the Authority is of the opinion that any bad debt cost amount included by the licensee in a claim form should not be reimbursed, it will notify the licensee, and give the licensee 28 days in which to make any representations, which the Authority will duly consider before deciding whether the amount should be reimbursed or not.

- (iii) Having carried out steps (i) and (ii), the Authority will, by 31 October in each Regulatory Year from 2015/16 to 2018/19, determine an updated eligible bad debt cost for the licensee for each Regulatory Year of the DPCR5 price control.

15.67 Subject to paragraph ~~15.66~~<sup>15.65</sup> (i), the licensee may submit one or more updated claims in relation to any particular debtor.

15.68 If the Authority has not received any completed claim forms by 30 June 2018, then the eligible bad debt cost for the licensee for each Regulatory Year of the DPCR5 price control will be fixed at zero (see also paragraphs ~~15.71~~<sup>15.70</sup> to ~~15.73~~<sup>15.72</sup>).

### Calculation of adjustment to allowed revenue for the licensee

15.69 The following steps are carried out to calculate the adjustment ~~to allowed revenue for the licensee~~:

- (i) By 31 October in each Regulatory Year from 2015/16 to 2018/19, DPCR5 Time Value of Money Adjustments will be applied to the updated eligible bad debt costs for the licensee for each Regulatory Year of DPCR5 obtained at step (iii) in paragraph ~~15.66~~<sup>15.65</sup> to put them on a common 2015/16 time value basis, and the values will then be totalled.
- (ii) Any provisional adjustment relating to DPCR5 DUoS Bad Debts that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (i).

15.70 The value obtained at step (ii) in paragraph ~~15.69~~<sup>15.68</sup> is the adjustment relating to DPCR5 DUoS Bad Debts for the licensee.

### **Determination of the DPCR5 DUoS Bad Debts adjustment value**

15.71 The Authority will determine a DPCR5 DUoS Bad Debts adjustment value for the licensee by 30 November 2015 for the purpose of determining the value of OLREV by 30 November 2015.

15.72 A revised DPCR5 DUoS Bad Debts adjustment value for the licensee will be determined by the Authority:

- (a) by 30 November 2016 for the purpose of determining the value of OLREV by 30 November 2016;
- (b) by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017; and
- (c) by 30 November 2018 for the purpose of determining the value of OLREV by 30 November 2018,

where that is required by the methodology set out in paragraphs ~~15.65~~~~15.64~~ to ~~15.70~~~~15.69~~.

15.73 No further revisions to the DPCR5 DUoS Bad Debts adjustment value for the licensee will be determined after 30 November 2018 for the purpose of determining a revised value of OLREV. However, if, after that date, the licensee makes a material recovery of bad debt amounts previously reimbursed through revisions to the value of OLREV, the Authority may take those recoveries into account in proposing the RIIO-ED2 price control arrangements for the licensee.

### **v) DPCR5 Traffic Management Act Permit Costs adjustment**

#### *References:*

- i. Chapter 2 of reference document 1 specified at the start of this chapter
- ii. Reference document 5 specified at the start of this chapter
- iii. Chapters ~~4~~ **and 7** of reference document 6 specified at the start of this chapter
- iv. Reference document 12 specified at the start of this chapter

#### **Overview**

15.74 This subsection sets out how we will determine the DPCR5 Traffic Management Act<sup>34</sup> Permit Costs adjustment to allowed revenue for the licensee. The term DPCR5 Traffic Management Act Permit Costs adjustment means the adjustment described in this subsection that relates to the DPCR5 traffic management permitting reopener that is set out in chapter 2 of reference document 1 and chapter 4 of reference document 6.

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<sup>34</sup> Traffic Management Act 2004

*Supplementary Detailed Assessment Procedures*

15.75 By 31 March 2016, the Authority will modify this handbook so that it sets out a detailed methodology (the "TMA Legacy Assessment Methodology") for assessing DPCR5 Traffic Management Permit Costs in accordance with CRC 4A (Governance of ED1 Price Control Financial Instruments).

15.76 The TMA Legacy Assessment Methodology will, in particular, set out the way in which the Authority will determine the input values marked ▲ in the calculation of adjustment set out in paragraph 15.85 below.

15.77 In formulating the TMA Legacy Assessment Methodology the Authority will take into account the following, without limitation:

- (a) the requirement to determine whether costs have been efficiently incurred by the licensee or not;
- (b) the policy set out in reference documents 2, 5, 6 and 12; and
- (c) further work on how to define and assess costs, undertaken by the Authority in conjunction with Electricity Distribution Network Operators during DPCR5.

*Background to adjustment*

15.78 Although some expenditure allowances for Traffic Management Act costs were deemed to be included in the calculation of DPCR5 Revenue Allowances for the licensee, these did not include any amounts in respect of permit requirements which were uncertain at the outset of DPCR5. The DPCR5 traffic management permitting reopener provides for the licensee to be given additional allowed revenue to reflect:

- (a) the number of cases where works projected at the outset of DPCR5 required the purchase of permits rather than the giving of notices;
- (b) the average cost of the permits referred to in subparagraph (a); and
- (c) an assumed rate of penalties and penalty costs associated with the permits referred to in subparagraph (a).

15.79 The total number of permit purchases, referred to in paragraph 15.77 (a) was made subject to a cap equal to the assumed number of required works notices for the whole of DPCR5 used in setting the licensee's DPCR5 Revenue Allowances.

15.80 The DPCR5 Traffic Management Act Permit Costs adjustment was made subject to a materiality test set at one percent of the licensee's DPCR5 Revenue Allowance for Regulatory Year 2010/11. This value will be restated in 2012/13 prices for the purposes of this section (v).

*DPCR5 reopener*

15.81 The licensee was able to apply for an adjustment during DPCR5 in a window that ran from 1 July to 31 July 2012, where at least six months' worth of permit data was available. Adjustments to revenue allowances determined under this provision were collected by the licensee as a component of the term UNC under Special Condition CRC 18 (Arrangements for the recovery of uncertain costs) of the



licence in the form it was in on 31 March 2015. Permit cost data not addressed through the DPCR5 reopener was logged up to be dealt with under the DPCR5 Traffic Management Act Permit Costs adjustment.

15.82 In order to calculate the DPCR5 Traffic Management Act Permit Costs adjustment value for the licensee, the Authority will require as a minimum the following information for every scheme for each Regulatory Year in the DPCR5 Price Control period:

- (a) the number of permits obtained by the licensee instead of notices;
- (b) permitting condition costs;
- (bc) the costs of permits incurred by the licensee during DPCR5;
- (ed) the incremental administration costs incurred by the licensee in respect of permitting requirements;
- (de) the system implementation costs incurred by the licensee in respect of permitting requirements; and
- (ef) the penalty costs incurred-borne by the licensee.

15.83 The information-adjustments referred to in paragraph 15.81 will be provisionally determined by the Authority by 31 August 2017, using price control information reported by the licensee and the TMA detailed assessment procedures.

15.84 After making the provisional determination referred to in paragraph 15.82 the Authority will consult with the licensee for at least 28 days and take into account any representations made by the licensee during that period.

15.85 Having carried out the consultation referred to in paragraph 15.83, the Authority will determine the input values to be used in the calculation of adjustment set out below (marked ▲).

### Calculation of adjustment

15.86 The following steps will be carried out to apply the materiality test referred to in paragraph 15.79 and, if applicable, to calculate the DPCR5 Traffic Management Act Permit Costs adjustment value for the licensee:

#### *Materiality test*

- (i) ▲The licensee's efficient incremental administration costs associated with permitting requirements for each Regulatory Year of DPCR5 will be restated in 2012/13 prices.
- (ii) The values obtained under step (i) will be multiplied by the DPCR5 IQI Incentive Rate for the licensee to calculate the incremental administration costs amount to be taken into account for each Regulatory Year in DPCR5 in 2012/13 prices.
- (iii) ▲The licensee's efficient permit costs for each Regulatory Year of DPCR5 will be restated in 2012/13 prices.

- (iv) ▲ The efficient permit penalty costs borne by the licensee for each Regulatory Year of DPCR5 will be restated in 2012/13 prices.
- (v) ▲ The licensee's permitting condition costs<sup>35</sup> associated with permitting requirements for each Regulatory Year of DPCR5 will be restated in 2012/13 prices.
- (vi) ▲ The licensee's system set up costs associated with permitting requirements for each Regulatory Year of DPCR5 will be restated in 2012/13 prices.
- (vii) The values obtained at steps (ii) to (vi) will be summed to give a total amount for each Regulatory Year of DPCR5 in 2012/13 prices.
- (viii) The values obtained at step (vii) will be summed to give a total value for DPCR5 in 2012/13 prices.
- (ix) The total value (restated in 2012/13 prices) of any DPCR5 reopener adjustment of the type referred to in paragraph **Error! Reference source not found.** for the licensee will be deducted from the value calculated at step (viii).
- (x) The materiality test value will be calculated as one percent of the DPCR5 Revenue Allowance for the licensee for Regulatory Year 2010/11, restated in 2012/13 prices.

15.87 If the value calculated under step (ix) in paragraph 15.85 is less than the materiality value calculated under step (x), then the calculated value of the DPCR5 Traffic Management Act Permit Costs adjustment for the licensee will be zero and steps (xi) to (xv) in paragraph 15.87 below will not be carried out.

15.88 If the value calculated under step (x) in paragraph 15.85 is greater than the materiality test value calculated under step (xi), then steps (xii) to (xvi) below will be carried out.

- (xi) The values obtained under step (i) will be multiplied by 85% to calculate an amount for each Regulatory Year in DPCR5 that would have been added to the licensee's RAV if the values calculated at step (i) had been taken into account.
- (xii) The values calculated at step (xi) will be used to calculate:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20); and
  - (b) an amount of return, at WACC for DPCR5 (applied to the NNRRB),
 for each Regulatory Year in DPCR5 on the basis of attributable, notional RAV balance impacts.

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<sup>35</sup> The costs associated with conditions imposed by local authorities or highway authorities.

- (xiii) The values obtained under step (i) will be multiplied by 15% to calculate the DPCR5 Fast Money amount for efficient incremental administration costs for each Regulatory Year in DPCR5 in 2012/13 prices.
- (xiv) The values obtained at steps (iii), (iv), (v), (vi), ~~and (xiii) and (xiv)~~ will be summed to give a total value for each Regulatory Year of DPCR5 in 2012/13 prices.
- (xv) DPCR5 Time Value of Money adjustments will be applied to the values calculated under step (xiv) to put them on a common 2015/16 time value basis and the values will then be totalled.

15.89 The following values will be deducted from the value calculated at step (xv) in paragraph 15.87 or, as applicable, the value of zero referred to in paragraph 15.86:

- (a) the total value (in 2012/13 prices) of any DPCR5 reopener adjustment of the type referred to in paragraph 15.80; and
- (b) any provisional DPCR5 Traffic Management Act Permit Costs adjustment (in 2012/13 prices) that was included in the calculation of the licensee's Opening Base Revenue Allowances.

#### *Restatement of price control information*

15.90 If, under any provision of the licence, before 31 July 2018, the licensee restates any price control information used in the determination of input values used in the calculation set out in paragraphs 15.85 to 15.88 above, the Authority will, by 31 ~~August-September~~ 2018, provisionally re-determine the information referred to in paragraph 15.81 using the restated information and the TMA detailed assessment procedures.

15.91 If applicable, after making any provisional re-determination referred to in paragraph 15.89 the Authority will consult with the licensee for at least 28 days and take into account any representations made by the licensee during that period.

15.92 If applicable, having carried out any consultation under paragraph 15.90, the Authority will re-determine the input values (marked ▲) to be used in a re-calculation of the adjustment value.

#### *Determination of the DPCR5 Traffic Management Act Permit Costs adjustment value*

15.93 The Authority will, by 30 November 2017, determine the DPCR5 Traffic Management Act Permit Costs adjustment value for the licensee to be the value calculated under paragraphs ~~15.85-86 to 15.88-89 November 2017~~ for the purpose of determining the value of OLREV by 30 November 2017.

15.94 If the Authority has re-calculated the adjustment value under paragraph ~~15.92~~, it will, by 30 November 2018, determine the DPCR5 Traffic Management Act Permit Costs adjustment value for the licensee to be the value calculated under that paragraph for the purpose of determining the value of OLREV by 30 November 2018.

15.95 The DPCR5 Traffic Management Act Permit Costs adjustment does not involve:

- (a) an adjustment to the licensee's RAV additions; or
- (b) an adjustment under the DPCR5 RAV Rolling Incentive (except in respect of incremental administration costs associated with permitting requirements).

15.96 No further revisions to the DPCR5 Traffic Management Act Permit Costs adjustment value for the licensee will be determined after 30 November 2018 for the purpose of determining a revised value of OLREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph [15.92](#) for any other purpose.

## **vi) DPCR5 Undergrounding and Worst Served Customer Improvements adjustment**

### *References:*

- i. Chapter 7 of reference document 1 specified at the start of this chapter
- ii. Reference document 5 specified at the start of this chapter
- iii. Chapters 9 and 15 of reference document 8 specified at the start of this chapter

15.97 This subsection sets out the methodology for determining the DPCR5 Undergrounding and Worst Served Customer Improvements adjustment to allowed revenue for the licensee.

15.98 The term DPCR5 Undergrounding and Worst Served Customer Improvements adjustment means the adjustment described in this subsection that relates to:

- the undergrounding in Areas of Outstanding Natural Beauty and National Parks mechanism; and
- the worst served customer improvements mechanism,

that are set out in chapters 9 and 15 of reference document 8 respectively and as further clarified in the DPCR5 Undergrounding and Worst Served Customer Improvement Closeout Methodology.

### **~~Determining the DPCR5 Undergrounding and Worst Served Customer Improvement Closeout Methodology~~**

~~15.99 — By 31 July 2015, the Authority will determine the DPCR5 Undergrounding and Worst Served Customer Improvement Closeout Methodology which it will apply when determining adjustments to the licensee's allowed revenue for RIIO-ED2 in respect of DPCR5 Undergrounding and Worst Served Customer Improvements.~~

~~15.100~~ ~~In determining the DPCR5 Undergrounding and Worst Served Customer Improvements Closeout Methodology, the Authority will take into account the following, without limitation:~~

- ~~———— (a) ———— Reference Documents 1, 5 and 8; and~~
- ~~———— (b) ———— Further work to develop the relevant information requirements for the assessment.~~

*Undergrounding in Areas of Outstanding Natural Beauty and National Parks mechanism*

~~15.101~~15.99 At the outset of the DPCR5 Price control, the licensee was given an allowance for expenditure on undergrounding distribution system assets to help preserve visual amenity in and around Areas of Outstanding Natural Beauty and National Parks. The allowance is specified in 2007/08 prices in Table 9.1 in reference document 8.

~~15.102~~15.100 The licensee was required to 'log up' its expenditure, with the allowance amount acting as an overall cap. However, eligible expenditure in excess of the cap is included in the separate calculation of the overall adjustment for items subject to the DPCR5 IQI Incentive Rates for the licensee (see paragraph ~~15.105~~15.106 and section 2 of chapter 16).

*Worst served customer improvements mechanism*

~~15.103~~15.101 At the outset of the DPCR5 Price Control, the licensee was given an allowance for expenditure on projects to improve distribution system performance for customers who had experienced a large numbers of supply interruptions over a number of years. The allowance is specified in 2007/08 prices in Table 15.1 in reference document 8.

~~15.104~~15.102 The licensee was required to 'log up' its expenditure, with the allowance amount acting as an overall cap. There was also an expenditure limit of £1,000 per customer (in 2007/08 prices) that applied on an average basis across all customers included in all projects across DPCR5. Eligible expenditure in excess of the cap/limit is included in the separate calculation of the overall adjustment for items subject to the DPCR5 IQI Incentive Rates for the licensee (see paragraph ~~15.105~~15.106 and section 2 of chapter 16).

*Calculation of consolidated DPCR5 Undergrounding and Worst Served Customer Improvements adjustment*

~~15.105~~15.103 The following steps are carried out to calculate the DPCR5 Undergrounding and Worst Served Customer Improvements adjustment value:

*Initial steps with respect to DPCR5 Undergrounding expenditure*

- (i) The overall DPCR5 Undergrounding expenditure allowance (cap) for the licensee will be obtained and restated in 2012/13 prices.
- (ii) The licensee's actual eligible DPCR5 Undergrounding expenditure for each Regulatory Year in DPCR5 will be obtained and restated in 2012/13 prices.

- (iii) The cumulative figure for actual DPCR5 Undergrounding expenditure for each Regulatory Year in DPCR5 will be calculated using the values obtained under step (ii).
- (iv) The amount of actual DPCR5 Undergrounding expenditure in excess of the cap referred to in step (i) will be calculated for each Regulatory Year in DPCR5 using the cumulative values calculated under step (iii).
- (v) Any positive (excess) value calculated under step (iv) will be deducted from the value obtained at step (ii) for the Regulatory Year concerned. In years where the spend is within the cap then no adjustment is made.

*Initial steps with respect to DPCR5 Worst Served Customer Improvements expenditure*

- (vi) The overall DPCR5 Worst Served Customer Improvements expenditure allowance (cap) for the licensee will be obtained and restated in 2012/13 prices.
- (vii) The expenditure limit per customer referred to in paragraph ~~15.102~~15.103 will be restated in 2012/13 prices.
- (viii) The licensee's eligible actual DPCR5 Worst Served Customer Improvements expenditure for each Regulatory Year in DPCR5 will be obtained and restated in 2012/13 prices.
- (ix) The values calculated at step (viii) will be summed to give a total value of eligible actual expenditure for the whole of DPCR5.
- (x) The total number of customers included in eligible Worst Served Customer Improvements projects by the licensee during DPCR5 will be obtained.
- (xi) The total value of eligible actual expenditure calculated at step (ix) will be divided by the total number of customers obtained at step (x) to derive the actual expenditure per customer.
- (xii) If the value of actual expenditure per customer calculated at step (xi) is greater than the restated expenditure limit per customer referred to in step (vii), then a limit per customer reduction factor is calculated by dividing the expenditure limit per customer at step (vii) by the actual expenditure per customer at step (xi).
- (xiii) If the value of actual expenditure per customer calculated at step (xi) is less than or equal to the restated expenditure limit per customer referred to in step (vii), then the value of the limit per customer reduction factor is set to one.
- (xiv) The limit per customer reduction factors calculated in either step (xii) or step (xiii) will be applied to restated eligible actual expenditure for each Regulatory Year in DPCR5 calculated in step (viii). These values will be referred to as the residual eligible actual expenditure.
- (xv) The cumulative values for residual eligible actual expenditure for each Regulatory Year in DPCR5 will be calculated using the values obtained under step (xiv).

- (xvi) The cumulative values for residual eligible actual expenditure for each Regulatory Year calculated under step (xv) will be compared to the expenditure cap calculated in step (vi).
- (xvii) If the cumulative value for residual eligible actual expenditure in any Regulatory Year calculated under step (xv) is lower than or equal to the expenditure cap calculated at step (vi) no adjustment is made to the value of residual eligible actual expenditure calculated in step (xiv) for the Regulatory Year.
- (xviii) If the cumulative value for residual eligible actual expenditure in any Regulatory Year calculated under step (xv) is higher than the expenditure cap calculated at step (vi), and this is the first Regulatory Year the cumulative value exceeds the expenditure cap, the excess amount above the expenditure cap will be deducted from the value of residual eligible actual expenditure calculated in step (xiv) for the Regulatory Year.
- (xix) If the cumulative value for residual eligible actual expenditure in any Regulatory Year calculated under step (xv) is higher than the expenditure cap calculated at step (vi), and this is not the first Regulatory Year the cumulative value exceeds the expenditure cap, the residual eligible actual expenditure is set to zero for the Regulatory Year.

*Consolidating steps to determine the DPCR5 Undergrounding and Worst Served Customer Improvements adjustment*

- ~~(xviii)~~ The amounts calculated at steps (v) and, as applicable (xvii), (xviii) or (xiv) will be summed to give the consolidated amount of actual expenditure within the consolidated expenditure allowance for each Regulatory Year in DPCR5, taking account of the expenditure limit per customer applicable to Worst Served Customer Improvements projects.
- ~~(xix)~~ The values calculated at step ~~(xviii)~~ will be multiplied by 15% to calculate DPCR5 Fast Money amounts for DPCR5 Undergrounding and Worst Served Customer Improvements for each Regulatory Year in DPCR5.
- ~~(xx)~~ The values calculated at step ~~(xviii)~~ will be multiplied by 85% to calculate an amount for each Regulatory Year in DPCR5 that would have been added to the licensee's RAV if the values calculated at step ~~(xviii)~~ had been taken into account.
- (xx) The values calculated at step (xix) will be used to calculate:
  - (a) an amount of depreciation (being the applicable value divided by 20 ~~and expressed as a positive amount~~); and
  - (b) an amount of return, at WACC for DPCR5 (applied to the NNRRB),
 for each Regulatory Year in DPCR5 on the basis of attributable, notional RAV balance impacts.
- (xxi) The values calculated at steps (xviii) and (xx) will be summed for each Regulatory Year in DPCR5.

- (xxii) ~~DPCR5~~ Time Value of Money Adjustments will be applied to the values calculated at step (xxi) to put them on a common 2015/16 time value basis and the values will then be totalled.
- (xxiii) Any provisional adjustment relating to DPCR5 Undergrounding and Worst Served Customer Improvements that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (xxii).

~~15.106~~**15.104** The value obtained at step (xxiii) in paragraph ~~15.103~~**15.104** is the DPCR5 Undergrounding and Worst Served Customer Improvements adjustment for the licensee.

~~15.107~~**15.105** The DPCR5 Undergrounding and Worst Served Customer Improvements adjustment does not involve an adjustment to the licensee's RAV additions. However, the licensee's actual expenditure amounts are used in the calculation of DPCR5 RAV Rolling Incentive adjustments for the licensee (see chapter 16).

~~15.108~~**15.106** The Authority will review the values reported by the licensee and associated performance information in accordance with the DPCR5 Undergrounding and Worst Served Customer Improvements Closeout Methodology.

### **Determination of the DPCR5 Undergrounding and Worst Served Customer Improvements adjustment value**

~~15.109~~**15.107** The Authority will complete a review of the DPCR5 Undergrounding and Worst Served Customer Improvement expenditure and associated performance for the licensee by 30 November 2015.

~~15.110~~**15.108** Subject to paragraphs ~~15.109~~**15.110** and ~~15.110~~**15.111**, the Authority will determine a revised DPCR5 Undergrounding and Worst Served Customer Improvements adjustment value for the licensee if, with respect to the values referred to in paragraph ~~15.106~~**15.107**:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality, with regard to a possible restatement requirement or in relation to required circuit improvements, it had attached to those values (see also paragraph 1.17 in chapter 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

~~15.111~~**15.109** A revised DPCR5 Undergrounding and Worst Served Customer Improvements adjustment value for the licensee may be determined by the Authority:

- (a) by 30 November 2016 for the purpose of determining the value of OLREV by 30 November 2016;
- (b) by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017; and



- (c) by 30 November 2018 for the purpose of determining the value of OLREV by 30 November 2018.

~~15.112~~**15.110** No further revisions to the DPCR5 Undergrounding and Worst Served Customer Improvements adjustment value for the licensee will be determined after 30 November 2018 for the purpose of determining a revised value of OLREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~15.106~~**15.107** for any other purpose.

## **vii) DPCR5 Load Related Re-opener - adjustment resulting from revised allowance levels**

### *References:*

- i. Chapter 2 of reference document 1 specified at the start of this chapter.
- ii. Reference document 5 specified at the start of this chapter.
- iii. Chapter 7 of reference document 6 and Appendix 4 in reference document 8 specified at the start of this chapter.

### **Overview**

~~15.113~~**15.111** This subsection sets out how we will determine the DPCR5 Load-Related Re-opener adjustment to allowed revenue for the licensee, using a two stage process:

- (i) determining revised expenditure allowance amounts; and
- (ii) calculating the allowed revenue adjustment.

~~15.114~~**15.112** The term DPCR5 Load-Related Re-opener (in this subsection the 're-opener') means the provision for reviewing the licensee's expenditure allowances for:

- (a) low volume high cost connections; and
- (b) general reinforcement,

over DPCR5, for the purpose of making any necessary adjustment to the licensee's revenue allowances. The provision is explained in this subsection and in chapter 2 of reference document 1 and chapter 7 of reference document 6.

### *Supplementary Detailed Assessment Procedures*

~~15.115~~**15.113** By 31 March 2016, the Authority will modify this handbook so that it sets out a detailed methodology (the "Load Related Re-opener Legacy Assessment Methodology") for assessing DPCR5 Load related Re-opener costs in accordance with CRC 4A (Governance of ED1 Price Control Financial Instruments).

~~15.116~~**15.114** The Load Related Re-opener Legacy Assessment Methodology will, in particular, set out the way in which the Authority will determine the input values marked ▲ in the calculation of adjustment set out in paragraph ~~15.139~~**15.138** below.

~~15.117~~**15.115** In formulating the Load Related Re-opener Legacy Assessment Methodology, the Authority will take into account the following, without limitation:

- (a) the requirement to determine whether costs have been efficiently incurred by the licensee or not;
- (b) the policy set out in reference documents 1, 6 and 8; and
- (c) further work on how to define and assess costs, undertaken by the Authority in conjunction with Electricity Distribution Network Operators during DPCR5.

#### *Background to adjustment*

~~15.118~~15.116 Baseline expenditure allowances for the licensee were specified as an aggregate amount (in 2007/08 prices), for the whole of DPCR5, in Special Condition CRC 18 of the licence in the form it was in on 31 March 2015.

~~15.119~~15.117 The re-opener provided for the licensee to be given additional amounts of allowed revenue, through revisions to expenditure allowance amounts, where qualifying expenditure was materially more than the baseline expenditure allowances set at the start of the DPCR5 Price Control. It also provided for reductions to the licensee's allowed revenue where qualifying expenditure was materially less than baseline expenditure allowances.

~~15.120~~15.118 The reopener can be triggered by:

- (a) a review by the Authority of the licensee's reported expenditure levels for DPCR5 (see paragraphs ~~15.121~~15.122 to ~~15.126~~15.127); or
- (b) an application lodged by the licensee during a window that runs from 1 ~~January~~May 2016 to 31 ~~January~~May 2016.

#### *Adjustment threshold and materiality test*

~~15.124~~15.119 The DPCR5 Load related Re-opener adjustment is subject to an adjustment threshold (for both upward and downward adjustments). In accordance with the threshold, only a portion of total DPCR5 qualifying expenditure (or saved expenditure), restated in 2012/13 prices, that is:

- (a) above a figure calculated as 120 per cent; or
- (b) below a figure calculated as 80 per cent,

of the aggregate baseline expenditure allowances figure referred to in paragraph ~~15.116~~15.117, restated in 2012/13 prices, (in this subsection a 'post-threshold' amount) will be taken into account for the purposes of any calculation of a DPCR5 Load related Re-opener adjustment.

~~15.122~~15.120 The DPCR5 Load related Re-opener adjustment is subject to a materiality test set at one percent of the licensee's DPCR5 Revenue Allowance for Regulatory Year 2010/11, restated in 2012/13 prices. The test is applied to a post-threshold amount (see paragraph ~~15.119~~15.120), multiplied by the DPCR5 IQI Incentive Rate for the licensee.

#### **Re-opener upon Authority review**

~~15.123~~15.121 A review by the Authority will only be commenced if:

- (a) the licensee's total DPCR5 qualifying expenditure (taking into account the factors in paragraph ~~15.130~~~~15.131~~) is sufficiently lower than its aggregate baseline expenditure allowances for there to be a post-threshold amount (see paragraph ~~15.119~~~~15.120~~); and
- (b) the materiality test set out in paragraph ~~15.120~~~~15.121~~ is passed.

~~15.124~~~~15.122~~ Subject to paragraph ~~15.121~~~~15.122~~, if the Authority commences a review, and forms a preliminary view (taking into account the factors in paragraph ~~15.130~~~~15.131~~) that reduced expenditure allowance amounts should be used to calculate a DPCR5 Load related Re-opener adjustment for the licensee, it will apprise the licensee of that preliminary view and allow the licensee at least 28 days in which to provide comments before initiating a consultation under paragraph ~~15.123~~~~15.124~~.

~~15.125~~~~15.123~~ Having considered any comments received from the licensee under paragraph ~~15.122~~~~15.123~~, the Authority will, by 31 March 2017, initiate a consultation with the licensee, network users, suppliers and other stakeholders. The Authority will allow at least two months after the publication of its consultation for the submission of any information that respondents consider should be taken into account in relation to its review.

~~15.126~~~~15.124~~ Where applicable, having considered any information received in response to its consultation, the Authority will, by 31 ~~July~~~~August~~ 2017, decide whether reduced expenditure allowance amounts should be used to calculate a DPCR5 Load related Re-opener adjustment for the licensee.

~~15.127~~~~15.125~~ In making any decision to use reduced expenditure allowance amounts to calculate an adjustment, the Authority will decide:

- (a) the proportion of the aggregate allowance figure referred to in paragraph ~~15.116~~~~15.117~~ that should be attributed to each Regulatory Year of DPCR5; and
- (b) the proportion of the post-threshold reduction amount that should be attributed to each Regulatory Year of DPCR5,

for the purpose of that calculation, having regard to the timing profile of actual expenditure reported by the licensee.

~~15.128~~~~15.126~~ If the Authority decides to use reduced expenditure allowance amounts to calculate a DPCR5 Load related Re-opener adjustment for the licensee it will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before calculating a DPCR5 Load-Related Re-opener adjustment under paragraph ~~15.138~~~~15.139~~.

### **Re-opener upon licensee's application**

~~15.129~~~~15.127~~ The licensee can apply for a re-opener during, and only during, the application window that runs from 1 May 2016 to 31 May 2016.

~~15.130~~~~15.128~~ The licensee may only apply for a re-opener if:

- (a) the licensee's total DPCR5 qualifying expenditure is sufficiently higher than its aggregate baseline expenditure allowances for there to be a post-threshold amount (see paragraph ~~15.119~~~~15.120~~); and
- (b) the materiality test set out in paragraph ~~15.120~~~~15.121~~ is passed.

~~15.131~~15.129 A re-opener application by the licensee must be prepared having regard to the provisions set out in reference documents 1 and 6 and must set out:

- (a) the proportion of the aggregate allowance figure referred to in paragraph ~~15.116~~15.117; and
- (b) the proportion of a post-threshold change to expenditure allowance amounts,

that the licensee considers should be attributed to each Regulatory Year of DPCR5, having regard to the timing profile of actual expenditure reported by the licensee, for the purpose of calculating a DPCR5 Load related Re-opener adjustment.

~~15.132~~15.130 A reopener application must include information requirements as specified in the Load Related Re-opener Legacy Assessment Methodology. This will include but not be limited to:

- (a) the costs incurred by the licensee on low volume high cost connections and general reinforcement activity during each Regulatory Year of DPCR5;
- (b) the variances of outturn values from values used in setting the licensee's DPCR5 Revenue Allowances in respect of:
  - (i) the number of low volume high cost connections carried out by the licensee; and
  - (ii) the proportion of costs for low volume high cost connections met by customer contributions;
- (c) the licensee's performance, with respect to accuracy and timeliness, in collecting customer contributions for connections work;
- (d) the relationship between activity levels and costs for:
  - (i) low volume high cost connections; and
  - (ii) general reinforcement;
- (e) the numbers of connections carried out by independent connection providers where the licensee was required to carry out associated non-contestable work;
- (f) load index output deliverables of the type referred to in reference document 6;
- (g) demand side management initiatives undertaken by the licensee; and
- (h) any other matters that the licensee considers are pertinent to its application.

~~15.133~~15.131 If a re-opener application is received by the Authority during the application window referred to in paragraph ~~15.127~~15.128, it will check that the requirements set out in the Load Related Re-opener Legacy Assessment Methodology have been met and that the application:

- (a) is based on information about low volume high cost connections and general reinforcement costs that was not available when the licensee's DPCR5 Revenue Allowances were derived;

- (b) relates to low volume high cost connections and general reinforcement costs incurred by the licensee during the DPCR5 price control period and does not include Real Price Effects;
- (c) relates to low volume high cost connections and general reinforcement costs that cannot be recovered under any other provision of the licence;
- (d) does not include costs on DPCR5 High Value Projects (see subsection ix));
- (e) includes direct costs on a net basis, setting customer contributions (relating to direct costs)<sup>36</sup> off against costs, and in 2012/13 prices; and
- (f) is based on efficient expenditure.

~~15.134~~15.132 Having made an initial review of the information referred to in paragraph ~~15.130~~15.131 and carried out the checks referred to in paragraph ~~15.131~~15.132, the Authority will ask the licensee to submit any additional information or clarifications it requires and will allow the licensee a reasonable amount of time to provide any such information.

~~15.135~~15.133 After considering the information referred to in paragraphs ~~15.130~~15.131 and ~~15.132~~15.133 in accordance with the Load Related Re-opener Legacy Assessment Methodology, the Authority will reach a preliminary view on whether to confirm, reject or amend the proposed changes to the licensee's expenditure allowance amounts referred to in paragraph ~~15.129~~15.130. The Authority will apprise the licensee of its initial view and allow the licensee at least 28 days in which to provide comments, before initiating a consultation under paragraph ~~15.134~~15.135.

~~15.136~~15.134 Having considered any comments received from the licensee under paragraph ~~15.133~~15.134 the Authority will, by 31 May 2017, initiate a consultation with the licensee, network users, suppliers and other stakeholders. The Authority will allow at least two months after the publication of its consultation for the submission of any information that respondents consider should be taken into account in relation to the licensee's re-opener application.

~~15.137~~15.135 Where applicable, having considered any information received in response to its consultation, the Authority will, by 31 ~~August~~September 2017, decide whether to confirm, reject or amend the proposed changes to the licensee's expenditure allowance amounts referred to in paragraph ~~15.129~~15.130 for the purpose of calculating a DPCR5 Load-Related Re-opener adjustment. In making its decision, the Authority will carry out its assessment in accordance with the Load Related Re-opener Legacy Assessment Methodology.

~~15.138~~15.136 The Authority will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before using the revised expenditure allowance amounts to calculate a DPCR5 Load-Related Re-opener adjustment under paragraph ~~15.138~~15.139.

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<sup>36</sup> Except for contribution amounts released from the licensee's balance sheet that relate to connections carried out before DPCR5.

~~15.139~~15.137 If the licensee does not apply for a re-opener during the application window that runs from 1 May 2016 to 31 May 2016, then the change to the licensee's expenditure allowance amounts under this provision (a re-opener upon the licensee's application), for the purposes of calculating the DPCR5 Load-related Re-opener adjustment for the licensee, will be zero.

### Calculation of DPCR5 Load-related Re-opener adjustment

~~15.140~~15.138 If the ~~authority~~Authority decides that revised expenditure allowance amounts should be used to calculate a DPCR5 Load-Related Re-opener adjustment as a result of:

- a re-opener upon Authority review (see paragraphs ~~15.121~~15.122 to ~~15.126~~15.127); or
- a re-opener upon licensee application (see paragraphs ~~15.127~~15.128 to ~~15.136~~15.137),

then the following steps will be carried out to calculate the DPCR5 Load-Related Re-opener adjustment value:

- (i) ▲ The efficient post-threshold change (reduction or increase) to the licensee's expenditure allowance amount for each Regulatory Year of DPCR5 will be assessed and stated in 2012/13 prices (see paragraphs ~~15.125~~15.126 and ~~15.129~~15.130).
- (ii) The values obtained under step (i) will be multiplied by 15% to calculate DPCR5 Fast Money amounts for the DPCR5 Load-related Re-opener adjustment for each Regulatory Year in DPCR5.
- (iii) The values obtained at step (i) will be multiplied by 85% to calculate an amount for each Regulatory Year in DPCR5 that would have been added to the licensee's RAV if the values calculated at step (i) had been taken into account.
- (iv) The values calculated at step (iii) will be used to calculate:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20 ~~and multiplied by minus~~ ~~1~~); and
  - (b) an amount of return, at WACC for DPCR5 (applied to the NNRRB),
 for each Regulatory Year in DPCR5 on the basis of attributable, notional RAV balance impacts.
- (v) The values obtained at steps (ii) and (iv) will be summed to give a total value for each Regulatory Year of DPCR5.
- (vi) DPCR5 Time Value of Money adjustments will be applied to the values calculated under step (v) to put them on a common 2015/16 time value basis and the values will then be totalled.
- (vii) Any provisional DPCR5 Load-related Re-opener adjustment that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (vi).

~~15.141~~15.139 The value obtained at step (vii) in paragraph ~~15.138~~15.139 is the DPCR5 Load-Related Re-opener adjustment for the licensee.

~~15.142~~15.140 The DPCR5 Load-Related Re-opener adjustment does not involve an adjustment to the licensee's RAV additions. However, the capitalised portions of any changes in expenditure allowance amounts (see step (iii) in paragraph ~~15.138~~15.139) are used in the calculation of DPCR5 RAV Rolling Incentive adjustments for the licensee (see chapter 16).

### **Determination of the DPCR5 Load-related Re-opener adjustment value**

~~15.143~~15.141 No revision to the DPCR5 Load-related Re-opener adjustment value for the licensee will be determined by 30 November 2017 for the purpose of determining the value of OLREV by 30 November ~~2017~~2016.

~~15.144~~ — ~~The Authority will use any revised expenditure allowance amounts resulting from a re-opener upon the Authority's review or upon the licensee's application to determine the DPCR5 Load-related Re-opener adjustment value for the licensee by 30 November 2018 for the purpose of determining the value of OLREV by 30 November 2018.~~

~~15.142~~ — ~~The Authority will use any revised expenditure allowance amounts resulting from a re-opener upon the Authority's review or upon the licensee's application to determine the DPCR5 Load-related Re-opener adjustment value for the licensee by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017.~~

~~15.145~~15.143 No further revisions to the DPCR5 Load-related Re-opener adjustment value for the licensee will be determined after 30 November ~~2018~~2017 for the purpose of determining a revised value of OLREV, ~~but this is without any prejudice to any requirement for the licensee to restate the values referred to in paragraph 15.139 for any other purpose.~~

### **viii) DPCR5 High Volume Connections Volume Driver - adjustment resulting from revised allowance levels**

#### *References:*

- i. Chapter 2 of reference document 1 specified at the start of this chapter
- ii. Chapter 7 of reference document 6 and Appendix 4 of reference document ~~8-7~~ specified at the start of this chapter
- iii. Chapter 10 of reference document 8 specified at the start of this chapter
- ~~iv. Reference document 5~~

#### **Overview**

~~15.146~~15.144 This subsection sets out the methodology for determining the DPCR5 High Volume Connections Volumes Driver adjustment to allowed revenue for the licensee, using a two stage process:

- (i) determining revised expenditure allowance amounts; and

- (ii) calculating the allowed revenue adjustment.

~~15.147~~15.145The term DPCR5 High Volume Connections Volume Driver (in this subsection the 'volume driver') means the provision for reviewing the licensee's expenditure allowances for:

- (a) small scale low voltage domestic and one-off commercial connections;
- (b) connections at low voltage but which involved some works at high voltage; and
- (c) all other low voltage connections (involving low voltage works only),

during DPCR5, for the purpose of making any necessary adjustment to the licensee's revenue allowances. The provision is explained in this subsection and in chapter 2 of reference document 1 and chapter 7 of reference document 6.

~~15.148~~15.146The volume driver provided for the licensee to be given additional (or reduced) amounts of allowed revenue, through revisions to expenditure allowance amounts, where:

- (a) the number of connections in one of more of the categories set out in paragraph ~~15.145~~15.146 was higher (or lower) than the forecast level used in setting the licensee's DPCR5 Revenue Allowances;
- (b) the percentage of costs covered by customer contributions for connections in one of more of the categories set out in paragraph ~~15.145~~15.146 was higher (or lower) than the forecast level used in setting the licensee's DPCR5 Revenue allowances; ~~and~~
- (c) a higher than expected number of connections were carried out by independent connection providers in the licensee's Distribution Services Area.

~~15.149~~15.147Revisions to the licensee's expenditure allowance amounts in respect of the items set out in subparagraphs ~~15.146~~15.147(a) and (b) will be calculated using the approach set out in paragraphs ~~15.156~~15.157 to ~~15.158~~15.159.

~~15.150~~15.148Revisions to the licensee's expenditure allowance amounts in respect of the item set out in subparagraph ~~15.146~~15.147(c) will be subject to the application and review process set out in paragraphs ~~15.159~~15.160 to ~~15.167~~15.168 below.

~~15.151~~15.149The baseline expenditure allowance for the licensee is specified as an aggregate amount, in 2007/08 prices, for the whole of DPCR5, in Table 2 of appendix 4 in reference document 7.

*Apportionment of DPCR5 High Volume Connections that were contracted prior to the start of DPCR5*

~~15.152~~15.150For DPCR5 High Volume Connections contracted after the start of DPCR5 (in this subsection 'DPCR5 contracted HVC'), categorisation information is held by the licensee.



~~15.153~~15.151 Some DPCR5 High Volume Connections were contracted prior to the start of DPCR5 (in this subsection 'pre-DPCR5 contracted HVC') and categorisation information is not held by the licensee.

~~15.154~~15.152 For the purpose of steps (i), (ii) and (iii) set out in paragraph ~~15.156~~15.157 below, the percentages of pre-DPCR5 contracted HVC to be included in the categories set out in paragraph ~~15.145~~15.146 will be determined according to the DPCR5 High Volume Connections Closeout Methodology.

~~15.155~~15.153 The percentage of pre-DPCR5 contracted HVC to be included in the 'small scale low voltage domestic and one-off commercial connections' category is derived by dividing:

- (a) the number of DPCR5 contracted HVC, completed during DPCR5, that are included in the 'small scale low voltage domestic and one-off commercial connections' category;  
by
- (b) the total number of DPCR5 contracted HVC completed during DPCR5.

~~15.156~~15.154 The percentage of pre-DPCR5 contracted HVC to be included in the 'connections at low voltage but which involved some works at high voltage' category is derived by dividing:

- (a) the number of DPCR5 contracted HVC, completed during DPCR5, that are included in the 'connections at low voltage but which involved some works at high voltage' category;  
by
- (b) the total number of DPCR5 contracted HVC completed during DPCR5.

~~15.157~~15.155 The percentage of pre-DPCR5 contracted HVC to be included in the 'all other low voltage connections (involving low voltage works only)' category is derived by dividing:

- (a) the number of DPCR5 contracted HVC, completed during DPCR5, that are included in the 'all other low voltage connections (involving low voltage works only)' category;  
by
- (b) the total number of DPCR5 contracted HVC completed during DPCR5.

### **Calculation of revised expenditure allowance amounts in respect of connection numbers and contribution levels**

~~15.158~~15.156 By 31 May ~~2015~~2016, the Authority will carry out the following steps to calculate revised expenditure allowance amounts in respect of connection numbers and contribution levels:

- (i) For small scale low voltage domestic and one-off commercial connections:

- (a) the number of connections carried out by the licensee; and
  - (b) the percentage of costs subject to recovery through use of system charges (as opposed to connection charges),

will be obtained for each Regulatory Year of DPCR5.
- (ii) For connections at low voltage but which involved some works at high voltage:
  - (a) the number of connections carried out by the licensee; and
  - (b) the percentage of costs subject to recovery through use of system charges (as opposed to connection charges),

will be obtained for each Regulatory Year of DPCR5.
- (iii) For other low voltage connections (involving low voltage works only):
  - (a) the number of connections carried out by the licensee; and
  - (b) the percentage of costs subject to recovery through use of system charges (as opposed to connection charges),

will be obtained for each Regulatory Year of DPCR5.
- (iv) The revised expenditure allowance amount in respect of small scale low voltage domestic and one-off commercial connections for each Regulatory Year in DPCR5 will be calculated as, the number obtained at step (i)(a) multiplied by the percentage obtained at step (i)(b) multiplied by the value for the licensee specified in the eighth column ('Final Proposals (FP) – Small scale') of Table 4 in Appendix 4 of reference document 7, restated in 2012/13 prices and multiplied by 1000, except where that value is zero, in which case it will be deemed to be equal to the highest value in that column, restated in 2012/13 prices .
- (v) The revised expenditure allowance amount in respect of other low voltage connections (involving low voltage works only)~~connections at low voltage but which involved some works at high voltage~~ for each Regulatory Year in DPCR5 will be calculated as, the number obtained at step (ii)(a) multiplied by the percentage obtained at step (ii)(b) multiplied by the value for the licensee specified in the ninth column ('Final Proposals (FP) – All other') of Table 4 in Appendix 4 of reference document 7, restated in 2012/13 prices, and multiplied by 1000.
- (vi) The revised expenditure allowance amount in respect of other low voltage connections (involving low-high voltage works only) for each Regulatory Year in DPCR5 will be calculated as, the number obtained at step (iii)(a) multiplied by the percentage obtained at step (iii)(b) multiplied by the value for the licensee specified in the tenth column ('Final Proposals (FP) – LV with HV') of Table 4 in Appendix 4 of reference document 7, restated in 2012/13 prices, .

- (vii) The values calculated at steps (iv), (v) and (vi) will be totalled and divided by 1 million for each Regulatory Year in DPCR5, to restate values from £ to £m.

~~15.159~~15.157 The values obtained at step (vii) in paragraph ~~15.156~~15.157 are the revised expenditure allowance amounts in respect of connection numbers and contribution levels for the licensee.

~~15.160~~15.158 In order to perform the steps set out in paragraph ~~15.156~~15.157, the Authority will require the values referred to in steps (i), (ii) and (iii) of that paragraph. These values, or data from which they can be derived, are due to be reported by the licensee by 31 July 2015 under applicable Regulatory Instructions and Guidance and will be reviewed by the Authority.

### **Review of expenditure allowances in respect of independent connection provider activity levels**

~~15.161~~15.159 The licensee can apply for an additional revision to expenditure allowance amounts in respect of independent connection provider activity levels during, and only during, a window that runs from 1 January 2016 to 31 January 2016.

~~15.162~~15.160 An application of the type referred to in paragraph ~~15.159~~15.160 must provide evidence in accordance with the DPCR5 High Volume Connections Driver Closeout Methodology and must set out the revision, in 2012/13 prices, that the licensee proposes should be made to its expenditure allowance amount for each Regulatory Year in DPCR5.

~~15.163~~15.161 If the costs referred to in paragraph ~~15.160~~15.161(b) are included in any DPCR5 Load-Related Re-opener application by the licensee (see subsection vii), then they must not also be included in an application under this subsection.

~~15.164~~15.162 If an application is received by the Authority during the window referred to in paragraph ~~15.159~~15.160, it will review any evidence provided under paragraph ~~15.160~~15.161 and will

- (a) take account of any relevant factors identified in its review of values relating to connection numbers and contribution levels referred to in paragraph ~~15.158~~15.159; and
- (b) ask the licensee to submit any additional information it requires, allowing the licensee a reasonable amount of time to provide any such information.

~~15.165~~15.163 After considering the information referred to in paragraphs ~~15.160~~15.161 and ~~15.162~~15.164, the Authority will reach a preliminary view on whether to confirm, reject or amend the proposed revision to the licensee's expenditure allowance amounts in respect of independent connection provider activity levels.

~~15.166~~15.164 Having reached the preliminary view referred to in paragraph ~~15.163~~15.164, the Authority will apprise the licensee of it, and allow the licensee at least 28 days in which to provide comments before initiating a consultation under paragraph ~~15.165~~15.166.

~~15.167~~15.165 Having considered any comments received from the licensee under paragraph ~~15.164~~15.165, the Authority will, by 31 May 2016, initiate a consultation with the licensee, network users, suppliers and other stakeholders. The Authority will allow at least two months after the publication of its consultation for the submission of any information that respondents consider should be taken into account in relation to the licensee's application.

~~15.168~~15.166 Where applicable, having considered any information received in response to its consultation, the Authority will, by 31 August ~~2016~~2017, decide whether to confirm, reject or amend the proposed revision to the licensee's expenditure allowance amounts for Regulatory Years in DPCR5 in respect of independent connection provider activity levels. ~~In making its decision, the Authority will apply the DPCR5 High Volume Connections Closeout Methodology.~~

~~15.169~~15.167 The Authority will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before using the revised expenditure allowance amounts in the calculation of a DPCR5 High Volume Connections Volume Driver adjustment under paragraph ~~15.168~~15.169.

### **Calculation of DPCR5 High Volume Connections Volume Driver adjustment**

~~15.170~~15.168 The following steps are carried out to calculate the DPCR5 High Volume Connections Volume Driver adjustment value:

- (i) The values obtained at step (vii) in paragraph ~~15.156~~15.157 will be added to any revision amounts decided upon under paragraph ~~15.166~~15.167 for each Regulatory Year in DPCR5.
- (ii) The aggregate baseline expenditure allowance referred to in paragraph ~~15.149~~15.150 will be restated in 2012/13 prices, divided by five, and an equal part allocated to each Regulatory Year in DPCR5.
- (iii) The value obtained at step (ii) for each Regulatory Year in DPCR5 will be subtracted from the value obtained at step (i) for the same Regulatory Year.
- (iv) The values obtained under step (iii) will be multiplied by 15% to calculate DPCR5 Fast Money amounts for the DPCR5 High Volume Connections Volume Driver adjustment for each Regulatory Year in DPCR5.
- (v) The values obtained at step (iii) will be multiplied by 85% to calculate an amount for each Regulatory Year in DPCR5 that would have been added to the licensee's RAV if the values calculated at step (iii) had been taken into account.
- (vi) The values calculated at step (v) will be used to calculate:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20);  
and
  - (b) an amount of return, at WACC for DPCR5 (applied to the NNRRB),

for each Regulatory Year in DPCR5 on the basis of attributable, notional RAV balance impacts.

- (vii) The values calculated at steps (iv) and (vi) will be summed for each Regulatory Year in DPCR5.
- (viii) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (vii) to put them on a common 2015/16 time value basis and the values will then be totalled.
- (ix) Any provisional adjustment relating to the DPCR5 High Volume Connections Volume Driver that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (viii).

~~15.171~~15.169 The value obtained at step (ix) in paragraph ~~15.168~~15.169 is the DPCR5 High Volume Connections Volume Driver adjustment for the licensee.

~~15.172~~15.170 The DPCR5 High Volume Connections Volume Driver adjustment does not involve an adjustment to the licensee's RAV additions. However, the capitalised portions of any changes in expenditure allowance amounts (see step (v) in paragraph ~~15.168~~15.169) are used in the calculation of DPCR5 RAV Rolling Incentive adjustments for the licensee (see chapter 16).

#### **Determination of the DPCR5 High Volume Connections Volume Driver adjustment value**

~~15.173~~15.171 No revision to the DPCR5 High Volume Connections Volume Driver adjustment value for the licensee will be determined by 30 November 2015 for the purpose ~~for the purpose~~ of determining the value of OLREV by 30 November 2015.

~~15.174~~15.172 The Authority will determine a DPCR5 High Volume Connections Volume Driver adjustment value for the licensee by 30 November 2016.

~~15.175~~15.173 No further revisions to the DPCR5 High Volume Connections Volume Driver adjustment value for the licensee will be determined after 30 November 2016 for the purpose of determining a revised value of OLREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~15.158~~15.159 for any other purpose.

#### **ix) DPCR5 High Value Projects Re-opener - adjustment resulting from revised allowance levels**

##### *References:*

- i. Chapter 2 of reference document 1 specified at the start of this chapter
- ii. Reference document 5 specified at the start of this chapter
- iii. Chapters 3 and 7 of reference document 6 specified at the start of this chapter
- iv. Chapter 19 and appendix 7 of reference document 8 specified at the start of this chapter
- v. Reference document 13 specified at the start of this chapter

## Overview

~~15.176~~**15.174** This subsection sets out how we will determine the DPCR5 High Value Projects Re-opener adjustment to allowed revenue for the licensee, using a three stage process:

- (i) determining revisions to expenditure allowance amounts:
  - (a) in relation to activity and cost levels; and
  - (b) relating to the achievement of agreed network outputs;
- (ii) calculating the allowed revenue adjustment in respect of the revision at subparagraph (i) (a) for inclusion in the calculation of the OLREV value for the licensee; and
- (iii) calculating any allowed revenue adjustment in respect of the revision at subparagraph (i) (b) that will constitute the 'DPCR5 High Value Projects - failure to deliver outputs' adjustment for inclusion in the calculation of the RIREV value for the licensee (see section 2 of chapter 16).

~~15.177~~**15.175** The term DPCR5 High Value Projects Re-opener adjustment means the provision for reviewing the licensee's expenditure allowances in respect of:

- (a) activity and cost levels; and
- (b) the achievement of agreed network outputs,

in respect of large investment projects that were expected to be carried out during DPCR5, that is set out in this subsection and in the reference documents noted above.

### *Supplementary Detailed Assessment Procedures*

~~15.178~~**15.176** By 31 March 2016, the Authority will modify this handbook so that it sets out a detailed methodology (the "High Value Projects Re-opener Legacy Assessment Methodology") for assessing DPCR5 High Value Projects Re-opener costs in accordance with CRC 4A (Governance of ED1 Price Control Financial Instruments).

~~15.179~~**15.177** The High Value Projects Re-opener Legacy Assessment Methodology will, in particular, set out the way in which the Authority will determine the input values marked ▲ in the calculation of adjustment set out in paragraph ~~15.215~~**15.216** below.

~~15.180~~**15.178** In formulating the High Value Projects Re-opener Legacy Assessment Methodology the Authority will take into account the following, without limitation:

- (a) the requirement to determine whether costs have been efficiently incurred by the licensee or not;
- (b) the policy set out in reference documents 1, 5, 6, 8 and 13;
- (c) further work on how to define and assess costs, undertaken by the Authority in conjunction with Electricity Distribution Network Operators during DPCR5.

~~15.181~~15.179 *Background to adjustment* Baseline expenditure allowances for the licensee were specified as an aggregate amount (in 2007/08 prices), for the whole of DPCR5, in Special Condition CRC 18 of the licence in the form it was in on 31 March 2015.

~~15.182~~15.180 The re-opener can be triggered by:

- (a) a review by the Authority of the licensee's reported expenditure levels and network outputs for DPCR5; and
- (b) an application lodged by the licensee during a window that runs from 1 May 2016 to 31 May 2016.

*Adjustment threshold and materiality test*

~~15.183~~15.181 Subject to paragraph ~~15.183~~15.184, the DPCR5 High Value Projects Re-opener adjustment is subject to an adjustment threshold (for both upward and downward adjustments). Under the threshold, only a portion of total DPCR5 High Value Projects expenditure (or saved expenditure), taking into account the factors in paragraph ~~15.205~~15.206, restated in 2012/13 prices, that is:

- (a) above a figure calculated as 120 per cent; or
- (b) below a figure calculated as 80 per cent,

of the aggregate baseline expenditure allowances figure referred to in paragraph ~~15.179~~15.180, restated in 2012/13 prices, (in this subsection a 'post-threshold' amount) will be taken into account for the purposes of any calculation of a High Value Projects adjustment.

~~15.184~~15.182 Subject to paragraph ~~15.183~~15.184, the DPCR5 High Value Projects Re-opener adjustment is subject to a materiality test set at one per cent of the licensee's DPCR5 Revenue Allowance for Regulatory Year 2010/11, restated in 2012/13 prices. The test is applied to a post-threshold amount (see paragraph ~~15.181~~15.182), multiplied by the DPCR5 IQI Incentive Rate for the licensee.

~~15.185~~15.183 The review of achievement of DPCR5 High Value Projects outputs referred to in paragraph ~~15.174~~15.175(b) and paragraphs ~~15.190~~15.191 to ~~15.200~~15.201 below is not subject to the adjustment threshold or materiality test and associated changes to expenditure allowance amounts do not count towards the adjustment threshold and materiality test amounts set out in paragraphs ~~15.181~~15.182 and ~~15.182~~15.183. However, the factors relating to any adjustment resulting from the Authority's Review of expenditure allowance amounts in relation to activity and cost levels or a reopener upon the licensee's application, will be taken into account by the Authority in any review of the achievement of DPCR5 High Value Projects outputs by the licensee.

**Review of expenditure allowances by the Authority in relation to activity and cost levels**

~~15.186~~15.184 A review by the Authority will only be commenced if:

- (a) the licensee's total DPCR5 High Value Projects expenditure is sufficiently lower than its aggregate baseline expenditure allowances

for there to be a post-threshold amount (see paragraph ~~15.181~~~~15.182~~); and

- (b) the materiality test set out in paragraph ~~15.182~~~~15.183~~ is passed.

~~15.187~~~~15.185~~ Subject to paragraph ~~15.184~~~~15.185~~, if the Authority commences a review, and forms a preliminary view, taking into account the factors in paragraph ~~15.205~~~~15.206~~, that reduced expenditure allowance amounts should be used to calculate a DPCR5 High Value Projects Re-opener adjustment for the licensee, it will apprise the licensee of that preliminary view and allow the licensee at least 28 days in which to provide comments before initiating a consultation under paragraph ~~15.186~~~~15.187~~.

~~15.188~~~~15.186~~ Having considered any comments received from the licensee under paragraph ~~15.185~~~~15.186~~ the Authority will, by 31 March 2017, initiate a consultation with the licensee, network users, suppliers and other stakeholders. The Authority will allow at least two months after the publication of its consultation for the submission of any information that respondents consider should be taken into account in relation to its review.

~~15.189~~~~15.187~~ Where applicable, having considered any information received in response to its consultation, the Authority will, by 31 ~~July~~~~August~~ 2017, decide whether reduced expenditure allowance amounts should be used to calculate a DPCR5 High Value Projects Re-opener adjustment for the licensee. In making its decision, the Authority will apply the DPCR5 High Value Projects Re-opener ~~Closeout~~ Legacy Assessment Methodology.

~~15.190~~~~15.188~~ In making any decision to use reduced expenditure allowance amounts to calculate an adjustment, the Authority will decide:

- (a) the proportion of the aggregate allowance figure referred to in paragraph ~~15.179~~ that should be attributed to each Regulatory Year of DPCR5; and
- (b) the proportion of the post-threshold reduction amount that should be attributed to each Regulatory Year of DPCR5,

for the purpose of that calculation, having regard to the timing profile of actual expenditure reported by the licensee.

~~15.191~~~~15.189~~ If the Authority decides to use reduced expenditure allowance amounts to calculate a DPCR5 High Value Projects Re-opener adjustment for the licensee it will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before calculating a DPCR5 High Value Projects Re-opener adjustment under paragraph ~~15.215~~~~15.216~~.

### **Review of achievement of DPCR5 High Value Projects outputs by the licensee**

#### *Supplementary Detailed Assessment Procedures*

~~15.192~~~~15.190~~ By 31 March 2016, the Authority will modify this handbook so that ~~it~~ sets out a detailed methodology (the "High Value Projects Outputs Review Methodology") for assessing DPCR5 High Value Projects outputs, in accordance with CRC 4A (Governance of ED1 Price Control Financial Instruments).



~~15.193~~15.191 In formulating the High Value Projects Outputs Review Methodology the Authority will take into account the following, without limitation:

- (a) the policy set out in reference documents 1, 5, 6, 8 and 13; and
- (b) further work on how to define and assess outputs, undertaken by the Authority in conjunction with Electricity Distribution Network Operators during DPCR5.

~~15.194~~15.192 The High Value Projects Outputs Review Methodology will, in particular, set out the way in which the Authority will determine any outputs gap value referred to in paragraph ~~15.194~~15.195 below.

~~15.195~~15.193 After 31 July 2016, the Authority will commence a qualitative DPCR5 High Value Projects outputs performance assessment with respect to the licensee in accordance with the High Value Projects Outputs Review Methodology. The purpose of the assessment is to determine whether any output gap has arisen which should lead to a downward adjustment to the licensee's allowed revenue (a DPCR5 High Value Projects - failure to deliver outputs adjustment).

~~15.196~~15.194 Having carried out the assessment referred to in paragraph ~~15.190~~15.191, the Authority will reach a preliminary view on any outputs gap that has arisen. If the Authority's view is that no outputs gap has arisen, then no further action with respect to a DPCR5 High Value Projects, failure to deliver outputs adjustment will be taken.

~~15.197~~15.195 If the Authority's view is that an outputs gap has arisen, then it will value the outputs gap for each Regulatory Year in DPCR5 in accordance with the High Value Projects Outputs Review Methodology.

~~15.198~~15.196 The Authority will then

- (a) multiply the values referred to in paragraph ~~15.195~~15.196 by the DPCR5 IQI Incentive Rate for the licensee multiplied by a factor of 1.025;
- (b) apply DPCR5 Time Value of Money Adjustments to the values calculated under subparagraph (a) to put them on a common 2015/16 time value basis and then total the values for the whole of DPCR5; and
- (c) multiply the total value calculated under subparagraph (b) by minus 1, so that it is a negative value.

~~15.199~~15.197 If the Authority forms a preliminary view that an outputs gap has arisen and it has valued that gap under paragraph ~~15.195~~15.196 and calculated a possible adjustment value under paragraph ~~15.196~~15.197, it will apprise the licensee of its preliminary view and allow the licensee at least 28 days in which to provide comments before initiating a consultation under paragraph ~~15.198~~15.199.

~~15.200~~15.198 Having considered any comments received from the licensee under paragraph ~~15.197~~15.198, the Authority will, by 31 March 2017, initiate a consultation with the licensee, network users, suppliers and other stakeholders. The Authority will allow at least two months after the publication of its consultation for the submission of any information that respondents consider should be taken into account in relation to its view.

~~15.201~~15.199 Where applicable, having considered any information received in response to its consultation, the Authority will, by 31 July 2017, decide whether any DPCR5 High Value Projects - failure to deliver outputs adjustment should be included in the calculation of a revised RIREV value for the licensee (see section 2 of chapter 16). In making its decision, the Authority will apply the DPCR5 High Value Projects Outputs ~~Assessment~~ ~~Closeout~~ Review Methodology.

~~15.202~~15.200 If the Authority decides that a DPCR5 High Value Projects - failure to deliver outputs adjustment should be applied, it will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before including a value in the calculation of a revised RIREV value for the licensee.

### **Reopener upon licensee application**

~~15.203~~15.201 The licensee may apply for a re-opener during, and only during, an application window that runs from 1 May 2016 to 31 May 2016.

~~15.204~~15.202 The licensee may only apply for a re-opener if:

- (a) the licensee's total DPCR5 High Value Projects expenditure is sufficiently higher than its aggregate baseline expenditure allowances for there to be a post-threshold amount (see paragraph ~~15.181~~15.182); and
- (b) the materiality test set out in paragraph ~~15.182~~15.183 is passed.

~~15.205~~15.203 A re-opener application by the licensee must be prepared having regard to the provisions set out in chapter 2 of reference document 1 and chapter 7 of reference document 6 as further clarified by the High Value Projects Re-opener Legacy Assessment Methodology and must set out the changes that are proposed to the licensee's expenditure allowance amounts for the purpose of calculating a DPCR5 High Value Projects Re-opener adjustment.

~~15.206~~15.204 A re-opener application by the licensee must set out:

- (a) the proportion of the aggregate baseline expenditure allowance figure referred to in paragraph ~~15.179~~15.180; and
- (b) the proportion of a post-threshold change to expenditure allowance amounts,

that the licensee considers should be attributed to each Regulatory Year of DPCR5, having regard to the timing profile of actual expenditure reported by the licensee, for the purpose of calculating a DPCR5 High Value Projects Re-opener adjustment.

~~15.207~~15.205 A re-opener application by the licensee must include information as specified in the High Value Projects Re-opener Legacy Assessment Methodology. This will include but not be limited to information on the following:

- (a) the costs incurred and output volumes achieved by the licensee for each Regulatory Year of DPCR5, showing unit costs for each output type included in DPCR5 High Value Project outputs reporting under relevant Regulatory Instructions and Guidance;
- (b) the revised expenditure allowance amounts that the licensee considers should apply for each Regulatory year of DPCR5;

- (c) reasons for any increases in unit and total costs compared to baseline amounts including changes to the scope of works included in projects;
- (d) the impact on costs of any external factors including changes to legislation, economic conditions, planning requirements and resource constraints;
- (e) developments relating to:
  - (i) technical complexities encountered and solutions developed;
  - (ii) new methods of working and other innovations;
  - (iii) asset condition and loading surveys, and their impact on costs;
- (f) interactions between DPCR5 High Value Projects and other requirements and any impact on costs;
- (g) the actions taken by managers of the licensee to optimise outputs and mitigate costs in the context of the matters set out in subparagraphs (a) to (f); and
- (h) any other information that the licensee considers is pertinent to its application.

~~15.208~~15.206 A re-opener application by the licensee must not include:

- (a) costs included in a DPCR5 Load-related Re-opener application or any other expenditure allowance review application by the licensee;
- (b) costs relating to Real Price Effects.

~~15.209~~15.207 If a re-opener application is received by the Authority during the application window referred to in paragraph ~~15.201~~15.202, it will check that the requirements set out in paragraph ~~15.202~~15.203 have been met and that the application:

- (a) is based on information about High Value Project costs that was not available when the licensee's DPCR5 Revenue Allowances were derived;
- (b) relates to High Value Project costs incurred by the licensee during the DPCR5 price control period;
- (c) relates to High Value Project costs that cannot be recovered under any other provision of the licence;
- (d) does not include costs included in a DPCR5 Load-Related Re-opener application or any other expenditure allowance review application by the licensee); and
- (e) is based on efficient expenditure.

~~15.210~~15.208 Having made an initial review of the information referred to in paragraph ~~15.205~~15.206 and carried out the checks referred to in paragraph ~~15.207~~15.208, the Authority will ask the licensee to submit any additional

information or clarifications it requires and will allow the licensee a reasonable amount of time to provide any such information.

~~15.211~~15.209 After reviewing the information referred to in paragraph ~~15.205~~15.206 and ~~15.208~~15.209, the Authority will reach a preliminary view on whether to confirm, reject or amend the proposed changes to the licensee's expenditure allowance amounts referred to in paragraph ~~15.204~~15.205 for the purpose of determining a DPCR5 High Value Projects Re-opener adjustment. In reaching its preliminary view, the Authority will apply the High Value Projects Re-opener Legacy Assessment Methodology .

~~15.212~~15.210 Having reached the preliminary view referred to in paragraph ~~15.209~~15.210, the Authority will apprise the licensee of its preliminary view and allow the licensee at least 28 days in which to provide comments before initiating a consultation under paragraph ~~15.211~~15.212.

~~15.213~~15.211 Having considered any comments received from the licensee under paragraph ~~15.210~~15.211, the Authority will, by 31 May 2017, initiate a consultation with the licensee, network users, suppliers and other stakeholders. The Authority will allow at least two months after the publication of its consultation for the submission of any information that respondents consider should be taken into account in relation to the licensee's reopener application.

~~15.214~~15.212 Where applicable, having considered any information received in response to its consultation, the Authority will, by 31 ~~August~~September 2017, decide whether to confirm, reject or amend the proposed changes to the licensee's expenditure allowance amounts for the purpose of calculating a DPCR5 High Value Projects Re-opener adjustment. In making its decision, the Authority will apply the DPCR5 High Value Projects Re-opener Closeout Methodology.

~~15.215~~15.213 The Authority will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before using the revised expenditure allowance amounts to calculate a DPCR5 High Value Projects Re-opener adjustment under paragraph ~~15.215~~15.216.

~~15.216~~15.214 If the licensee does not apply for a re-opener during the application window that runs from 1 May 2016 to 31 May 2016, then the change to the licensee's expenditure allowance amounts under this provision (a re-opener upon the licensee's application), for the purposes of calculating the DPCR5 High Value Projects adjustment for the licensee, will be zero.

### **Calculation of DPCR5 High Value Projects Re-opener adjustment**

~~15.217~~15.215 If the ~~authority~~Authority decides that revised expenditure allowance amounts should be used to calculate a DPCR5 High Value Projects Re-opener adjustment following:

- a re-opener upon Authority review (see paragraphs ~~15.184~~15.185 to ~~15.189~~15.190); or
- a re-opener upon licensee application (see paragraphs ~~15.201~~15.202 to ~~15.213~~15.214),

then the following steps will be carried out to calculate the DPCR5 High Value Projects Re-opener adjustment value:

- (i) ▲The efficient post-threshold change (reduction or increase) to the licensee's expenditure allowance amount for each Regulatory Year of DPCR5 will be obtained and stated in 2012/13 prices (see paragraphs ~~15.188~~~~15.189~~ and ~~15.204~~~~15.205~~).
- (ii) The values obtained under step (i) will be multiplied by 15% to calculate DPCR5 Fast Money amounts for the DPCR5 High Value Projects Re-opener adjustment for each Regulatory Year in DPCR5.
- (iii) The values obtained at step (i) will be multiplied by 85% to calculate an amount for each Regulatory Year in DPCR5 that would have been added to the licensee's RAV if the values calculated at step (i) had been taken into account.
- (iv) The values calculated at step (iii) will be used to calculate:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20);  
and
  - (b) an amount of return, at WACC for DPCR5 (applied to the NNRRB),  
for each Regulatory Year in DPCR5 on the basis of attributable, notional RAV balance impacts.
- (v) The values obtained at steps (ii) and (iv) will be summed to give a total value for each Regulatory Year of DPCR5.
- (vi) DPCR5 Time Value of Money adjustments will be applied to the values calculated under step (v) to put them on a common 2015/16 time value basis and the values will then be totalled.
- (vii) Any provisional DPCR5 High Value Projects Re-opener adjustment that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (vi).

~~15.218~~~~15.216~~ The value obtained at step (vii) in paragraph ~~15.215~~~~15.216~~ is the DPCR5 High value Projects Re-opener adjustment for the licensee.

~~15.219~~~~15.217~~ The DPCR5 High value Projects Re-opener adjustment does not involve an adjustment to the licensee's RAV additions. However, the capitalised portions of any changes in expenditure allowance amounts (see step (iii) in paragraph ~~15.215~~~~15.216~~) are used in the calculation of DPCR5 RAV Rolling Incentive adjustments for the licensee (see chapter 16).

#### **Determination of DPCR5 High Value Projects Re-opener adjustment value for inclusion in the OLREV value**

~~15.220~~~~15.218~~ No revision to the DPCR5 High Value Projects Re-opener adjustment value for inclusion in the OLREV value for the licensee will be determined by 30 November 2016 for the purpose for the purpose of determining the value of OLREV by 30 November 2016.

~~15.221~~~~15.219~~ The Authority will use any revised expenditure allowance amounts resulting from a re-opener upon the Authority's review or upon the licensee's application to determine the High Value Projects adjustment value for inclusion in the

OLREV value for the licensee by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017.

~~15.222~~15.220 No further revisions to the DPCR5 High Value Projects Re-opener adjustment value for the licensee will be determined after 30 November 2017~~8~~ for the purpose of determining a revised value of OLREV but this is without prejudice to any requirement for the licensee to restate values referred to in paragraph 15.213 for any other purpose.

## **x) DPCR5 Enhanced Physical Site Security and Black Start - adjustment resulting from revised allowance levels**

### *References:*

- i. Chapter 2 of reference document 1 specified at the start of this chapter
- ii. Reference document 5 specified at the start of this chapter
- iii. Chapter 7 of reference document 6 and Appendix 6 in reference document 8 specified at the start of this chapter

### **Overview**

~~15.223~~15.221 This subsection sets out the methodology for determining the DPCR5 Enhanced Physical Site Security and Black Start adjustment to allowed revenue for the licensee, using a two stage process:

- (i) determining efficient expenditure levels; and
- (ii) calculating the allowed revenue adjustment.

~~15.224~~15.222 The term DPCR5 Enhanced Physical Site Security and Black Start adjustment means the provision for determining the licensee's efficient expenditure on:

- (a) Enhanced Physical Site Security; and
- (b) Black Start capability (including emergency batteries),

for DPCR5, described in this subsection and set out in paragraphs 7.37 to 7.40 in chapter 7 of reference document 6 and appendix 6 in reference document ~~8-7~~ and calculating any associated adjustment to the licensee's allowed revenue for RIIO-ED1.

### *Materiality test*

~~15.225~~15.223 The DPCR5 Enhanced Physical Site Security and Black Start adjustment is subject to a materiality test set at one percent of the licensee's DPCR5 Revenue Allowance for Regulatory Year 2010/11. This value will be restated in 2012/13 prices for the purposes of this methodology.

### **Logging up of expenditure**

~~15.226~~15.224 No baseline expenditure allowances were included in the calculation of the licensee's DPCR5 Revenue Allowances. The licensee was required to report its expenditure levels on Enhanced Physical Site Security and Black Start capability annually during DPCR5 under relevant Regulatory Instructions and Guidance. In this way, the costs were 'logged up' to be considered by the Authority with regard to an adjustment to the licensee's allowed revenues for RIIO-ED1.

*Review of logged up expenditure by the Authority*

~~15.227~~15.225 The licensee is due to report its logged up expenditure on Enhanced Physical Site Security and Black Start capability for DPCR5 by 31 July 2015, with supporting information to show that:

- its expenditure was pursuant to:
  - mandatory requirements;
  - or, with respect to Black Start capability,
  - relevant engineering technical recommendations;
- it followed any official guidance relating to measures being fit for purpose and value for money;
- costs were efficiently incurred, for example by demonstrating that competitive tendering was used in procurement; and
- the risks, costs and benefits associated with alternative solutions were considered, where permissible.

~~15.228~~15.226 The licensee may also include any other information it considers should be taken into account by the Authority.

~~15.229~~15.227 Having received the licensee's submission, the Authority will check:

- that all the information required under relevant Regulatory Instructions and Guidance has been included by the licensee; and
- that reported costs were incurred by the licensee on Enhanced Physical Site Security and Black Start capability during DPCR5 and that they cannot be recovered under any other provision of the licence.

~~15.230~~15.228 In considering the licensee's submission, the Authority will also review the annual cost reporting submissions made by the licensee during DPCR5 and the outcome of any enquiries raised in relation to those submissions.

~~15.231~~15.229 If the Authority requires any further information to make its decision in relation to the licensee's expenditure levels it will, by 31 January 2016, ask the licensee to submit it, allowing the licensee a reasonable amount of time for the purpose.

~~15.232~~15.230 If, having completed the review referred to in paragraphs ~~15.227~~15.228, the Authority is satisfied that the licensee's reported expenditure on Enhanced Physical Site Security and Black Start capability has been efficient then it will, subject to the materiality test referred to in paragraph ~~15.223~~15.224 use the reported expenditure values to calculate a DPCR5 Enhanced Physical Site Security and Black Start adjustment for the licensee under paragraph ~~15.232~~15.233.

~~15.233~~15.231 If, having completed the review referred to in paragraphs ~~15.227~~15.228 to ~~15.229~~15.230, the Authority decides that the licensee's reported expenditure on Enhanced Physical Site Security and Black Start capability should be curtailed for the purpose of calculating a DPCR5 Enhanced Physical Site Security and Black Start adjustment, it will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before using the reduced values to calculate an adjustment under paragraph ~~15.232~~15.233.

### **Calculation of DPCR5 Enhanced Physical Site Security and Black Start - adjustment**

~~15.234~~15.232 The following steps will be carried out to apply the materiality test referred to in paragraph ~~15.223~~15.224:

#### *Materiality test*

- (i) The licensee's efficient expenditure amount for each Regulatory Year in DPCR5 will be obtained. The values will be restated in 2012/13 prices.
- (ii) The values obtained at step (i) will be totalled, and the total will be multiplied by the DPCR5 IQI Incentive Rate for the licensee.
- (iii) The materiality test value will be calculated as one percent of the DPCR5 Revenue Allowance for the licensee for Regulatory Year 2010/11, restated in 2012/13 prices.

~~15.235~~15.233 If the value calculated under step (ii) in paragraph ~~15.232~~15.233 is less than the materiality value calculated under step (iii), then the calculated value of the DPCR5 Enhanced Physical Site Security and Black Start adjustment for the licensee will be zero and the steps set out in paragraph ~~15.234~~15.235 below will not be carried out.

~~15.236~~15.234 If the value calculated under step (ii) in paragraph ~~15.232~~15.233 is greater than the materiality test value calculated under step (iii), then the steps set out below will be carried out to calculate the DPCR5 Enhanced Physical Site Security and Black Start adjustment value for the licensee:

- (i) The values obtained at step (i) in paragraph ~~15.232~~15.233 will be multiplied by 15% to calculate DPCR5 Fast Money amounts for Enhanced Physical Site Security and Black Start capability costs for each Regulatory Year in DPCR5.
- (ii) The values obtained at step (i) in paragraph ~~15.232~~15.233 will be multiplied by 85% to calculate an amount for each Regulatory Year in DPCR5 that would have been added to the licensee's RAV if the values calculated under that step had been taken into account.
- (iii) The values calculated at step (ii) will be used to calculate:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20);
  - and



- (b) an amount of return, at WACC for DPCR5 (applied to the NNRRB),  
for each Regulatory Year in DPCR5 on the basis of attributable, notional RAV balance impacts.
- (iv) The values obtained at steps (i) and (iii) will be summed to give a total value for each Regulatory Year of DPCR5.
- (v) DPCR5 Time Value of Money adjustments will be applied to the values calculated under step (iv) to put them on a common 2015/16 time value basis and the values will then be totalled.

~~15.237~~15.235 Any provisional DPCR5 Enhanced Physical Site Security and Black Start –adjustment that was included in the calculation of the licensee’s Opening Base Revenue Allowances will be deducted from the value calculated at step (v) in paragraph ~~15.234~~15.235 or, as applicable, the value of zero referred to in paragraph ~~15.233~~15.234.

~~15.238~~15.236 The value obtained under paragraph ~~15.235~~15.236 is the DPCR5 Enhanced Physical Site Security and Black Start adjustment for the licensee.

~~15.239~~15.237 The DPCR5 Enhanced Physical Site Security and Black Start adjustment does not involve an adjustment to the licensee’s RAV additions. However, the capitalised portions of any changes in expenditure allowance amounts (see step (ii) in paragraph ~~15.234~~15.235) are used in the calculation of DPCR5 RAV Rolling Incentive adjustments for the licensee (see chapter 16).

### **Determination of the DPCR5 Enhanced Physical Site Security and Black Start adjustment value**

~~15.240~~15.238 The Authority will determine the DPCR5 Enhanced Physical Site Security and Black Start adjustment value for the licensee by 30 November 2016 for the purpose of determining the value of OLREV by 30 November 2016.

~~15.241~~15.239 Subject to paragraphs ~~15.240~~15.241 and ~~15.241~~15.242, the Authority will determine a revised DPCR5 Enhanced Physical Site Security and Black Start adjustment value for the licensee if, with respect to the values referred to in paragraph ~~15.225~~15.226:

- (a) the Authority apprised the licensee, by 31 ~~October~~November 2016, of \_\_\_\_\_ any provisionality it had attached to those values with regard to a \_\_\_\_\_ possible restatement requirement (see also paragraph 1.17 in chapter \_\_\_\_\_ 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

~~15.242~~15.240 A revised DPCR5 Enhanced Physical Site Security and Black Start adjustment value for the licensee may be determined by the Authority by 30 November 2017 for the purpose of determining the value of OLREV by 30 November 2017.

~~15.243~~15.241 No further revisions to the DPCR5 Enhanced Physical Site Security and Black Start adjustment value for the licensee will be determined after 30 November

2017 for the purpose of determining a revised value of OLREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~15.225~~~~15.226~~ for any other purpose.

## xi) DPCR5 Shetland adjustment

### References:

- i. Reference document 15 specified at the start of this chapter.

### Overview

~~15.244~~~~15.242~~This subsection only applies to SSEH. It sets out the methodology for determining:

- (a) a DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment; and
- (b) a DPCR5 NINES Project allowances adjustment,

for SSEH.

~~15.245~~~~15.243~~The two adjustments set out in paragraph ~~15.242~~~~15.243~~ together constitute the DPCR5 Shetland adjustment for SSEH.

~~15.246~~~~15.244~~The terms Shetland Integrated Plan and Shetland Competitive Process have the meanings given in the Authority's open letter entitled "Ofgem's determination of Scottish Hydro Electric Power Distribution plc's (SHEPD) submission required under Charge Restriction Condition (CRC) 18A" dated 22 April 2014 (see reference document 15 specified at the start of this chapter).

~~15.247~~~~15.245~~The term NINES Project means the trial for innovative options to manage the supply and demand of electricity on Shetland that SSEH was required to propose under Special Condition CRC 18A of its licence in the form it was in on 31 March 2015.

~~15.248~~~~15.246~~It should be noted that the adjustment set out in this subsection does not cover:

- (a) costs relating to energy provision on Shetland that were categorised as pass-through costs for DPCR5; and
- (b) any costs relating to energy provision on Shetland (including Shetland Competitive Process costs) incurred during the Price Control Period.

### DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment

~~15.249~~~~15.247~~The basis for funding DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process costs (ie costs incurred by SSEH during DPCR5) was set out in reference document 15 specified at the start of this chapter.

~~15.250~~15.248 DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process costs are considered under two headings:

- (a) costs invoiced to SSEH under the terms of contracts with unrelated parties; and
- (b) costs incurred directly by SSEH or recharged to it by an Affiliate or a Related Undertaking of SSEH where the arrangements were made on an arms length basis and on normal commercial terms.

~~15.251~~15.249 An amount of £1.58m (in 2012/13 prices) in respect of DPCR5 Shetland Integrated Plan and DPCR5 Competitive Process costs was taken into account in the calculation of Opening Base Revenue Allowances for SSEH.

*Application by SSEH for reimbursement of additional DPCR5 Shetland Integrated Plan and DPCR5 Competitive Process costs*

~~15.252~~15.250 Subject to paragraph ~~15.251~~15.252, it is open to SSEH to apply for additional costs to be reimbursed under the DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment. Any such application must be made by 31 December 2015 and must include the information set out in paragraph ~~15.253~~15.254.

*DPCR5 Shetland Integrated Plan costs*

~~15.253~~15.251 With respect to DPCR5 Shetland Integrated Plan costs, SSEH may only apply for the reimbursement of costs incurred directly by it, or recharged or invoiced to it by one of its Affiliates or Related Undertakings (see paragraph ~~15.248~~15.249(b)).

*DPCR5 Shetland Competitive Process costs*

~~15.254~~15.252 With respect to DPCR5 Shetland Competitive Process costs, SSEH may apply for the reimbursement of:

- (a) costs incurred directly by it, or recharged or invoiced to it by one of its Affiliates or Related Undertakings, where the arrangements were made on an arms length basis and on normal commercial terms; and
- (b) costs invoiced to it under the terms of contracts with unrelated parties.

*Information requirements*

~~15.255~~15.253 The information referred to in paragraph ~~15.250~~15.251 that SSEH must include in any application for reimbursement of additional costs is:

- (a) a breakdown of the costs by the Regulatory Years in DPCR5 in which they were incurred;
- (b) a narrative statement describing the activities giving rise to the costs, setting out, in particular:
  - why the activities were necessary; and
  - evidence that costs were efficiently incurred.

- (c) information on the amount of time worked by staff employed by SSEH (or its Affiliates or Related Undertakings) on development of the Shetland Integrated Plan and Competitive Process during DPCR;
- (d) information on the costs of the time worked referred to in subparagraph (b) with reference to staff grades and charging rates;
- (e) information on the amounts recharged or invoiced to SSEH by Affiliates or Related Undertakings and evidence that arrangements were made on an arms length basis and on normal commercial terms;
- (f) a description of relevant contractual arrangements between SSEH and Affiliates or Related Undertakings; and
- (g) any other matters that the licensee considers are pertinent to its application.

~~15.256~~15.254 The information referred to in subparagraphs (c), (d), (e) and (f) of paragraph ~~15.253~~15.254 must be derived from management information such as time sheets and management accounts used by the licensee, and which are available for submission under paragraph ~~15.256~~15.257 below if necessary.

~~15.257~~15.255 Any application under paragraph ~~15.250~~15.251 must be in respect of costs, stated in 2012/13 prices, that cannot be recovered under any other provisions of the licence.

#### *Review and determination by the Authority*

~~15.258~~15.256 Having made an initial review of the information referred to in paragraph ~~15.253~~15.254, the Authority will ask the licensee to submit any additional information or clarifications it requires and will allow the licensee a reasonable amount of time to provide any such information.

~~15.259~~15.257 The Authority will complete a review of SSEH's application by 31 July 2016 and, having done so, will consult the licensee on its provisional determination of revised amounts of costs that should be reimbursed, giving the licensee at least 28 days in which to respond.

~~15.260~~15.258 The Authority will consider any representations made by SSEH in response to the consultation referred to in paragraph ~~15.257~~15.258 and, having done so, will by 31 October 2016 determine either:

- (a) that no additional costs should be reimbursed under the DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment, in which case the value of the adjustment will be zero; or
- (b) that an amount of additional costs should be reimbursed under the DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment.

~~15.261~~15.259 If the Authority determines that an amount of additional costs should be reimbursed then it will, by 31 October 2016, determine the DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment for SSEH to be a value derived as:

- the amount of additional costs that it has determined should be reimbursed, with DPCR5 Time Value of Money adjustments to put them on a common 2015/16 time value basis;  
less
- the amount, in respect of DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustments, that was provisionally included in the calculation of Opening Base Revenue Allowances for SSEH.

~~15.262~~15.260 Subject to paragraph ~~15.258~~15.259(a), the value obtained under paragraph ~~15.259~~15.260 is the DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment value for SSEH.

~~15.263~~15.261 The DPCR5 Shetland Integrated Plan and DPCR5 Shetland Competitive Process adjustment does not involve an adjustment to the licensee's RAV additions.

### **DPCR5 NINES Project allowances adjustment**

~~15.264~~15.262 In a letter dated 25 November 2011, addressed to SSEH, the Authority determined that SSEH should be given a total funding amount for the NINES project of £15.33m in 2011/12 prices.

~~15.265~~15.263 The Authority also determined that the following amounts (in 2011/12 prices) should be recovered by SSEH as value of the term UNC under Special Condition CRC 4 (Restriction of Distribution Charges: calculation of the Allowed Pass-Through Items) of its licence in the form it was in on 31 March 2015:

- £3.96m in Regulatory Year 2012/13;
- £1.05m in Regulatory Year 2013/14; and
- £1.06m in Regulatory Year 2014/15.

~~15.266~~15.264 There is therefore a residual amount of £9.24m (in 2011/12 prices) to be recovered from the total funding amount referred to in paragraph ~~15.262~~15.263. This amount, restated in 2012/13 prices is £9.53m

~~15.267~~15.265 The Authority will, by 31 October 2015, determine the DPCR5 NINES Project allowances adjustment for SSEH to be a value derived as £9.53m minus the amount, in respect of the DPCR5 NINES Project allowances adjustment, that was provisionally included in the calculation of Opening Base Revenue Allowances for SSEH.

~~15.268~~15.266 The terms of funding for the NINES project did not provide for any additions to SSEH's RAV balance and the DPCR5 NINES Project allowances adjustment does not involve an adjustment under the DPCR5 RAV Rolling Incentive.

~~15.269~~15.267 It should be noted that the DPCR5 NINES Project allowances adjustment is separate from, and does not interact with, the provision relating to the cost of integrating solutions from the NINES project set out in paragraph ~~7.17-2~~(d) in section 7 of chapter 7 of this handbook.

### Determination of the DPCR5 Shetland adjustment value

~~15.270~~15.268 The Authority will, by 30 November 2015, determine the DPCR5 Shetland adjustment value to be £6.96m (in 2012/13 prices) representing the DPCR5 NINES Project allowances adjustment provided for in paragraphs ~~15.262~~15.263 to ~~15.267~~15.268, for the purpose of determining the value of OLREV by 30 November 2015.

~~15.271~~15.269 The Authority will, by 30 November 2016, determine the DPCR5 Shetland adjustment value to be the value determined under paragraph ~~15.268~~15.269 plus the value determined under paragraph ~~15.260~~15.261 for the purpose of determining the value of OLREV by 30 November 2016.

~~15.272~~15.270 No further revisions to the DPCR5 Shetland adjustment value for the licensee will be determined after 30 November 2016 for the purpose of determining a revised value of OLREV.

### xii) Determination of the OLREV value for the licensee

~~15.273~~15.271 This subsection sets out the methodology by which the Authority will determine the value of OLREV for the licensee and subsequently direct any revisions to that value under section 4 of this chapter, and in accordance with Part B of CRC 3A.

~~15.274~~15.272 The Authority will determine the value of OLREV for the licensee by 30 November in each Regulatory Year from 2015/16 to 2018/19, by summing the most recently determined values for each of the ten adjustments set out in Table 1 in CRC3A.

~~15.275~~15.273 Timings for the determination of each adjustment are set out in the respective subsections of this section. ~~Table 15.3 below, summarises these timings, indicating for each determination of the OLREV value, the adjustment values that are liable to have changed since the previous determination.~~

**Table 15.3—Timings for determination of adjustments comprising the OLREV value**

<b>Adjustment</b>	<b>Provision for determination of revised adjustment value by</b>							
	30-Nov 2015	30-Nov 2016	30-Nov 2017	30-Nov 2018	30-Nov 2019	30-Nov 2020	30-Nov 2021	30-Nov 2022
DPCR5 Pension adjustment	yes	possible	possible	no	no	no	no	no
DPCR5 Tax adjustment	yes	possible	possible	no	no	no	no	no
DPCR5 Distributed Generation adjustment	yes	possible	possible	no	no	no	no	no
DPCR5 DUoS Bad Debts adjustment	yes	yes	yes	yes	no	no	no	no
DPCR5 Traffic Management Act Permit Costs adjustment	yes	possible	no	no	no	no	no	no
DPCR5 Undergrounding and Worst Served Customer Improvements adjustment	yes	possible	possible	possible	no	no	no	no
DPCR5 Load Related Re-opener—adjustment resulting from revised allowance levels	no	yes	no	no	no	no	no	no
DPCR5 High Volume Connections Re-opener—adjustment resulting from revised allowance levels	no	yes	no	no	no	no	no	no
DPCR5 High Value Projects Re-opener—adjustment resulting from revised allowance levels	no	yes	no	no	no	no	no	no
DPCR5 Enhanced Physical Site Security and Black Start—adjustment resulting from revised allowance levels	no	yes	possible	no	no	no	no	no
DPCR5 Shetland adjustment	yes	yes	no	no	no	no	no	no

~~15.276~~15.274 The OLREV value is only contained in the column for Regulatory Year 2015/16 in the PCFM Variable Values Table for the licensee. The opening value of OLREV for the licensee, as at 1 April 2015, will be zero (see also paragraph 13.7 in chapter 13). Functionality within the PCFM means that the change to the licensee's revenue allowance, represented by the OLREV value, is spread across recalculated base revenue figures for the whole Price Control Period with Time Value of Money Adjustments.

~~15.277~~15.275 Determinations of the OLREV value for the licensee will be in 2012/13 prices.

### **Section 3 – Determination of revisions to the PCFM Variable Values for legacy adjustments to DPCR5 RAV Additions (OLRAV values)**

#### *References:*

- i. Chapter 1 of reference document 1 specified at the start of this chapter
- ii. Reference document 5 specified at the start of this chapter
- iii. Chapter 2 of reference document 9 specified at the start of this chapter

~~15.278~~15.276 This section sets out the methodology by which the Authority will determine revised OLRAV values for the licensee in accordance with Part C of CRC 3A, for direction under section 4.

~~15.279~~15.277 OLRAV values are only contained in the columns for Regulatory Years 2013/14 and 2014/15 in the PCFM Variable Values Table for the licensee. The opening OLRAV values for the licensee, as at 1 April 2015, will be zero (see also paragraph 13.7 in chapter 13).

#### *Calculation of revised OLRAV values*

~~15.280~~15.278 At the outset of RIIO-ED1, the Authority derived estimated values for RAV additions relating to Regulatory Years 2013/14 and 2014/15 in accordance with the applicable DPCR5 Cost, Volume and Revenue Reporting Regulatory Instructions and Guidance (see reference document 4).

~~15.281~~15.279 By 31 October 2015, the Authority will derive finalised RAV additions values for the licensee for Regulatory Years 2013/14 and 2014/15 by:

- (a) obtaining the RAV additions value for:
  - (i) Regulatory Year 2013/14; and
  - (ii) Regulatory Year 2014/15,

for the licensee displayed at the top of worksheet C4 (RAV) due to be submitted by the licensee by 31 July 2015 in accordance with the version of the Electricity Distribution Price Control Cost and Revenue Reporting - Regulatory Instructions and Guidance that were valid for reporting of 2014/15 actual costs and restating them in 2012/13 prices;



- (b) adding to the values obtained at subparagraph (a), any adjustment due in respect of refunded connection charges to distributed generators for the Regulatory Year concerned, in 2012/13 prices, to the extent that such addition is not already included in the value at subparagraph (a); and
- (c) applying:
  - (i) any adjustment relating to DPCR5 ongoing pension expenditure referred to in paragraphs 15.13 and 15.14;
  - (ii) any adjustment relating to DPCR5 Pension Protection Fund Levy expenditure referred to in paragraph 15.19; and
  - (iii) any adjustment due in respect of the true up of forecast costs to actual costs for ongoing pension costs in Regulatory Year 2009/10<sup>37</sup>,in each case in 2012/13 prices.

*Derivation of revised OLRAV values*

~~15.282~~15.280A revised OLRAV value for the licensee will be derived by deducting the estimated RAV additions for Regulatory Years 2013/14 and 2014/15 referred to in paragraph ~~15.278~~15.279 (restated in 2012/13 prices) from the finalised RAV additions derived under paragraph ~~15.279~~15.280.

**Determination of the OLRAV value**

~~15.283~~15.281The values referred to in paragraph ~~15.279~~15.280, are due to be reported by the licensee under applicable Regulatory Instructions and Guidance by 31 July 2015. The Authority will complete a review of the reported values by 31 October 2015 and, subject to paragraph ~~15.282~~15.283, will use the values to determine a revised OLRAV value for the licensee by 30 November 2015.

~~15.284~~15.282 Subject to paragraphs ~~15.283~~15.284 and ~~15.284~~15.285, the Authority will determine a revised OLRAV value for the licensee if, with respect to the values referred to in paragraph ~~15.279~~15.280:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality it had attached to those values with regard to a possible restatement requirement (see also paragraph 1.17 in chapter 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

~~15.285~~15.283A revised OLRAV value for the licensee may be determined by the Authority:

- (a) by 30 November 2016; and

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<sup>37</sup> This value will be unchanged from that used to derive the estimated RAV additions referred to in paragraph 15.278

(b) by 30 November 2017.

~~15.286~~15.284 No further revisions to the OLRAV value for the licensee will be determined after 30 November 2017, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~15.279~~15.280 for any other purpose.

#### **Section 4 – Direction of revisions to the OLREV value and to OLRAV values**

~~15.287~~15.285 Paragraph 3A.34 of CRC 3A requires the Authority to give the licensee at least 14 days' notice setting out any proposed revisions to the OLREV value and to OLRAV values that it has determined, before directing the revisions. This means that the Authority will give notice to the licensee of any 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.

~~15.288~~15.286 Having complied with the notice requirements, the Authority will direct any required revisions to:

- the OLREV value by 30 November in each Regulatory from 2015/16 to 2018/19; and
- The OLRAV value by 30 November in each Regulatory from 2015/16 to 2017/18.

##### *Delay in direction of revised PCFM Variable Values*

~~15.289~~15.287 If, for any reason, the Authority does not give a required direction of a revision to the OLREV value or to OLRAV values by 30 November in a particular Regulatory Year, CRC 3A 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 CRC 4B (Annual Iteration Process for the PCFM).

## 16. Legacy DPCR5 RAV Rolling Incentive adjustments - financial methodologies

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### Reference documents

1. [\[DPCR5\] Electricity Distribution Price Control Review Final Proposals – Financial Methodologies](https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-%E2%80%93-financial-methodologies)  
<https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-%E2%80%93-financial-methodologies>
2. [\[DPCR5\] Electricity Distribution Price Control Review Final Proposals – Incentives and Obligations](https://www.ofgem.gov.uk/ofgem-publications/46748/fp2incentives-and-obligations-final.pdf)  
<https://www.ofgem.gov.uk/ofgem-publications/46748/fp2incentives-and-obligations-final.pdf>
3. [\[DPCR5\] Electricity Distribution Price Control Review Final Proposals – Allowed Revenue - Cost assessment](https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-allowed-revenue-cost-assessment)  
<https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-price-control-review-final-proposals-allowed-revenue-cost-assessment>
4. [Network Outputs and Quality of Service Regulatory Instructions and Guidance - Version 2](https://www.ofgem.gov.uk/ofgem-publications/46606/nadprrigsv2published1.pdf)  
<https://www.ofgem.gov.uk/ofgem-publications/46606/nadprrigsv2published1.pdf>
5. [Electricity Distribution Price Control Review Final Proposals - Allowed revenue - Cost assessment appendix](https://www.ofgem.gov.uk/ofgem-publications/46749/fp3cost-asesment-network-investmentappendix.pdf)  
<https://www.ofgem.gov.uk/ofgem-publications/46749/fp3cost-asesment-network-investmentappendix.pdf>

### Section 1 - Overview

16.1 This chapter contains the methodologies for determining legacy adjustments associated with the DPCR5 RAV Rolling Incentive mechanism set out in Table 2 in CRC3A (Legacy price control adjustments) and revisions to the associated PCFM Variable Value (the RIREV value) for the licensee.

16.2 The methodologies referred to in paragraph 16.1 take into account any provisional adjustments that were included in the determination of the licensee's Opening Base Revenue Allowances.

#### Overview of the DPCR5 RAV Rolling Incentive

16.3 Paragraphs 16.5 to 16.12 below provide a high level description of the DPCR5 RAV Rolling Incentive. The detailed and definitive provisions, including a worked example, are set out in chapter 2 of reference document 1. References in CRC 3A and in this handbook to the DPCR5 RAV Rolling Incentive mean the RAV Rolling Incentive Mechanism described in this section.

16.4 The RAV Rolling Incentive was the main expenditure incentive mechanism in the DPCR5 price control. It has been superseded by the Totex Incentive ~~Mechanism~~ Mechanism in the RIIO-ED1 Price Control (see chapter 6).

16.5 Total expenditure allowances were set for the licensee at the outset of DPCR5 for costs covered by the DPCR5 Equalised Incentive.

16.6 An incentive strength rate was also set for the licensee at the outset of the price control period as a result of analysis of the licensee's expenditure proposals compared to Ofgem's view of expenditure requirements. An incentive strength rate of, for example, 45% would mean that the licensee would retain 45 percent of any underspend (versus its expenditure allowances) but bear 45% of any overspend. This can be viewed as the 'intended effect'. The effective incentive strength rates ("IQI Incentive Rates") for the licensee were set out in Appendix 1 of Special Condition CRC 18 (Arrangements for the recovery of uncertain costs) of the licence in the form it was in on 31 March 2015.

16.7 The DPCR5 RAV Rolling Incentive only operated directly on the Slow Money component of costs covered by the DPCR5 Equalised Incentive. Accordingly, the incentive strength percentage used in calculations was adjusted downwards in calculations to achieve the overall intended effect. For example, an incentive strength rate of 45% is adjusted to 35% for use in DPCR5 RAV Rolling Incentive calculations.

16.8 After the end of the DPCR5 price control period, a full set of expenditure allowances and actual expenditure figures will be available. Calculations can therefore be made of:

- (i) the income due under the intended effect referred to above; and
- (ii) the actual revenue effects that the licensee can be considered to have experienced during DPCR5.

16.9 The expenditure allowances referred to in paragraph 16.8 include any revisions applied in accordance with the adjustment methodologies set out in subsection (v) and subsections (vii) to (x) in section 2 of chapter 15.

16.10 The calculations referred to in paragraph 16.8 are carried out in constant 2012/13 prices and incorporate DPCR5 Time Value of Money Adjustments so that the intended and actual outcomes can be compared on a common 2015/16 time value basis.

16.11 Depending on the timing of any over/under-spend by the licensee during the five years of DPCR5, the values referred to at subparagraphs 16.8 (i) and (ii) may be different. A key feature of the DPCR5 RAV Rolling Incentive was that the intended effect should be achieved whatever the timing profile of under/over-expenditure. Consequently, if the figures at 16.8 (i) and (ii) are found to be different, a true-up adjustment is applied, which might be a positive or negative value in both over and under-spend scenarios. If the values match, then no further adjustment is due.

16.12 Under the terms of the DPCR5 price control, the Slow Money component of all efficient expenditure covered by the DPCR5 Equalised Incentive in the DPCR5

period is included in the RAV balance brought forward at the start of the RIIO-ED1 Price Control Period. Accordingly, the full incentive effect of the DPCR5 RAV Rolling Incentive will have been achieved with respect to the DPCR5 price control period once any provisional/legacy adjustments in respect of a difference of the type referred to in paragraph 16.11 have been applied.

### **Scheme specific variations**

16.13 There are two items that are subject to particular treatment under the wider RAV Rolling Incentive.

#### *Customer contribution levels for DPCR5 Rising and Lateral Mains*

16.14 In setting the licensee's DPCR5 expenditure allowances for work on Rising and Lateral Mains, the Authority used an assumption that the licensee would receive no contributions from customers.

16.15 The adjustment relating to the level of customer contributions is based on the premise that, all other things being equal, a higher level of contributions will represent a saving that should be shared between the licensee and consumers. A special incentive strength rate of ten percent applies, meaning that the licensee retains ten percent of any increase in customer contribution levels with 90 percent being recouped for customers.

16.16 This adjustment only applies to SP Distribution plc and SP Manweb plc - see subsection (iv) in section 2 of this chapter.

#### *DPCR5 Workforce Renewal*

16.17 The licensee's expenditure allowances for DPCR5 Workforce Renewal, that were included in the calculation of its DPCR5 Revenue Allowances, were subject to a "use it or lose it" mechanism.

16.18 Any overspend in respect of DPCR5 Workforce Renewal is subject to the normal incentive strength rate for the licensee referred to in paragraph 16.6. However, any underspend is subject to a zero percent incentive strength rate, meaning that 100% of any underspend is recouped for customers - see subsection (v) in section 2 of this chapter.

### **Adjustments in respect of failure to deliver outputs**

16.19 The Authority's final proposals for the DPCR5 Price Control also provided for adjustments to be made to the licensee's revenue allowances in certain circumstances in the event of a gap between the adjusted outputs the licensee was expected to achieve and the outputs it actually achieved - see subsections (ii) and (iii) in section 2 of this chapter.

## Section 2 – Determination of revisions to the PCFM Variable Value for legacy adjustments associated with the DPCR5 RAV Rolling Incentive mechanism (the RIREV value)

16.20 This section sets out the methodologies for determining the adjustment values that comprise the PCFM Variable Value for legacy adjustments associated with the DPCR5 RAV Rolling Incentive mechanism.

16.21 The adjustment values referred to in paragraph 16.20 are set out in Table 2 in CRC3A which is reproduced below. The methodologies in subsections (i) to (v) of this section set out the key features and principles of the individual adjustment mechanisms but they do not attempt to reproduce all of the detailed criteria contained in relevant DPCR5 price control decisions. Therefore, reference is made to the Authority's previous price control decisions where appropriate.

16.22 Table 2 in CRC3A is reproduced below.

**Table 16.1 - Table 2 in CRC3A - Adjustments comprising the RIREV value**

<b>Adjustment</b>	<b>Section of chapter 16 of the ED1 Price Control Financial Handbook containing methodology</b>
Adjustment for items subject to the DPCR5 IQI Incentive Rates for the licensee	Section 2 (i)
DPCR5 High Value Projects - failure to deliver outputs adjustment	Section 2 (ii)
DPCR5 Network Output Measures - failure to deliver outputs adjustment	Section 2 (iii)
DPCR5 Rising and Lateral Mains – adjustment relating to the level of customer contributions.	Section 2 (iv)
DPCR5 Workforce Renewal - adjustment resulting from overspend or underspend against allowances	Section 2 (v)

### i) Adjustment for items subject to DPCR5 IQI Incentive Rates

*References:*

- i. Chapter 2 of reference document 1 specified at the start of this chapter
- ii. Chapter 19 and appendix 7 of reference document 2 specified at the start of this chapter
- iii. Reference document 4 specified at the start of this chapter

16.23 This subsection sets out the methodology for determining adjustments to the licensee's allowed revenue for RIIO-ED1 in respect of items subject to DPCR5 IQI Incentive Rates (see definition in Glossary).

### **Calculation of adjustment for items subject to DPCR5 IQI Incentive Rates**

16.24 The following steps will be carried out to calculate the adjustment for items subject to DPCR5 IQI Incentive Rates:

#### *Calculation of intended incentive effect (see paragraph 16.8(i))*

- (i) The licensee's actual DPCR5 Slow Money expenditure will be obtained for each Regulatory Year in DPCR5 in 2012/13 prices (see paragraph 16.26).
- (ii) The licensee's adjusted total expenditure allowance for DPCR5 Slow Money expenditure will be obtained for each Regulatory Year in DPCR5 in 2012/13 prices (see paragraph 16.27).
- (iii) The value obtained at step (ii) will be deducted from the value obtained at step (i) to calculate an over or (under) spend value for each Regulatory year in DPCR5.
- (iv) The values calculated at step (iii) will be multiplied by the Adjusted DPCR5 IQI Incentive Rate for the licensee for the Regulatory Year concerned.
- (v) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (iv) to put them on a common 2015/16 time value basis and the values will then be totalled to give the intended incentive effect amount.

#### *Calculation of incentive gain or loss that the licensee can be considered to have experienced during DPCR5 (see paragraph 16.8(ii))*

- (vi) The values obtained at step (iii) will be used to calculate a notional value attributable to:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20);  
and
  - (b) return, at the WACC for DPCR5 (applied to the NNRRB),in respect of the licensee's under or over spend for each Regulatory Year in DPCR5.

- (vii) The values calculated at steps (vi)(a) and (b) will be summed for each Regulatory Year in DPCR5.
- (viii) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (vii) to put them on a common 2015/16 time value basis and the values will then be totaled.

*Calculation of adjustment for items subject to DPCR5 IQI Incentive Rates*

- (ix) The value calculated at step (v) will be deducted from the value calculated at step (viii).
- (x) Any provisional adjustment for items subject to DPCR5 IQI Incentive Rates that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (ix).

16.25 The value obtained at step (x) in paragraph 16.24 is the adjustment for items subject to the DPCR5 IQI Incentive Rates for the licensee for the licensee.

**Derivation of values used in calculation of adjustment for items subject to DPCR5 IQI Incentive Rates**

*Total actual DPCR5 Slow Money expenditure for each Regulatory Year in DPCR5*

16.26 The Authority will derive the licensee's total actual DPCR5 Slow Money expenditure for each Regulatory Year in DPCR5 as:

- the RAV additions value for the licensee for the Regulatory Year concerned shown at the head of worksheet C4 (RAV) due to be submitted by the licensee by 31 July 2015 in accordance with the applicable DPCR5 Cost, Volume and Revenue Reporting Regulatory Instructions and Guidance (see reference document 4), restated in 2012/13 prices; ~~and~~

less

- the consolidated amount of actual expenditure within the consolidated expenditure allowance for DPCR5 Undergrounding and Worst Served Customer Improvements for each Regulatory Year in DPCR5 obtained at step (~~xviii~~) in paragraph ~~15.10315.104~~ in 2012/13 prices
- the DPCR5 Slow Money component of DPCR5 ongoing pension ~~56~~expenditure;
- the DPCR5 Slow Money component of DPCR5 Pension Protection Fund Levy expenditure;
- the DPCR5 Slow Money component of DPCR5 Workforce Renewal expenditure;
- the amount of customer contributions received for Rising and Lateral Mains (SP Distribution plc and SP Manweb plc only).

*Adjusted total capex allowance for each Regulatory Year in DPCR5 ~~Regulatory Year in DPCR5~~*



16.27 The Authority will derive the licensee's adjusted total capex allowance for each Regulatory Year in DPCR5 by taking the opening capex allowance set against the licensee's name in Table 16.2 below for the year concerned and adding to it the each of the adjustment values set out in paragraphs 16.28 to 16.3416.33, in each case for the same Regulatory Year and stated in 2012/13 prices.

**Table 16.2 – Opening capex allowances (£m in 2012/13 prices)**

Licensee <sup>38</sup>	Regulatory Year				
	2010/11	2011/12	2012/13	2013/14	2014/15
ENWL	170.51	190.08	191.57	163.20	168.25
NPgN	119.65	120.64	127.08	131.44	127.48
NPgY	164.81	167.41	164.04	166.84	173.07
<del>WMID</del>	<del>189.35</del>	<del>194.97</del>	<del>206.51</del>	<del>210.18</del>	<del>213.53</del>
<del>EMID</del>	<del>191.38</del>	<del>199.74</del>	<del>220.16</del>	<del>216.16</del>	<del>215.44</del>
<del>SWALES</del>	<del>79.03</del>	<del>83.43</del>	<del>88.30</del>	<del>88.60</del>	<del>89.59</del>
<del>SWEST</del>	<del>113.76</del>	<del>126.38</del>	<del>131.64</del>	<del>135.13</del>	<del>136.09</del>
LPN	139.77	150.50	162.62	174.39	187.41
SPN	139.41	153.25	168.28	184.17	201.07
EPN	216.19	228.96	243.40	257.25	271.77
SPD	127.67	135.42	138.40	146.65	142.49
SPMW	173.57	167.83	179.62	172.89	174.58
SSEH	88.94	85.85	85.50	84.57	88.67

<sup>38</sup> Acronyms refer to the Electricity Distribution Network Operators as set out in paragraph 1A. 7 of CRC 1A.

SSES	227.74	230.35	236.21	232.26	223.89
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16.28 The first of the adjustment values referred to in paragraph 16.27 is the change to the licensee’s expenditure allowance amount determined under subsection vii) of section 2 in chapter 15 for the purpose of determining the DPCR5 Load related Re-opener adjustment value for the licensee, multiplied by 85 percent.

16.29 The second of the adjustment values referred to in paragraph 16.27 is the change to the licensee’s expenditure allowance amount determined under subsection viii) of section 2 in chapter 15 for the purpose of determining the DPCR5 High Volume Connections Re-opener adjustment value for the licensee, multiplied by 85 percent.

16.30 The third of the adjustment values referred to in paragraph 16.27 is the change to the licensee’s expenditure allowance amount determined under subsection ix) of section 2 in chapter 15 for the purpose of determining the DPCR5 High Value Projects adjustment value for the licensee, multiplied by 85 percent.

16.31 The fourth of the adjustment values referred to in paragraph 16.27 is:

- (a) zero if the materiality test referred to in subsection x) of section 2 in chapter 15 is not passed;

or, if that materiality test is passed,

- (b) the amount of expenditure on Enhanced Physical Site Security and Black Start capability used to calculate a DPCR5 Enhanced Physical Site Security and Black Start adjustment for the licensee under the provisions of subsection x) of section 2 in chapter 15, multiplied by 85 percent.

16.32 The fifth of the adjustment values referred to in paragraph 16.27 is:

- (a) zero if the materiality test referred to in subsection v) of section 2 in chapter 15 is not passed;

or, if that materiality test is passed,

- (b) the amount of expenditure on TMA permit incremental administration costs used in the calculation of a DPCR5 Traffic Management Act Permit Costs adjustment for the licensee under the provisions of subsection v) of section 2 in chapter 15, multiplied by 85 percent.

16.33 The sixth of the adjustment values referred to in paragraph 16.27 is the change to the licensee’s expenditure allowance amount determined under subsection xi) of section 2 in chapter 15 for the purpose of determining the DPCR5 Shetland Integrated Plan and Competitive Process adjustment value for the licensee, multiplied by 85 percent.

16.34 The seventh and last of the adjustment values referred to in paragraph 16.27 is the change to the licensee's expenditure allowance amount determined under the Rising and Lateral mains reopener, referred to in chapter 2 of reference document 1 and chapter 7 of reference document 7, that was taken into account in the calculation of the licensee's Opening Base revenue Allowances, multiplied by 85 percent. This paragraph only applies to SP Distribution plc and SP Manweb plc.

### **Determination of adjustment for items subject to DPCR5 IQI Incentive Rates**

16.35 The latest date by which any of the values used in the calculation of the adjustment for items subject to DPCR5 IQI Incentive Rates can be revised is 30 Nov 2018.

16.36 The Authority will determine a provisionally revised value for the adjustment for items subject to DPCR5 IQI Incentive Rates for the licensee by 30~~5~~ November 2015 for the purpose of determining the value of RIREV by 30 November 2015.

16.37 The Authority will also determine

- (a) a revised value for the adjustment for items subject to DPCR5 IQI Incentive Rates for the licensee by 30 November 2016 for the purpose of determining the value of RIREV by 30 November 2016; ~~and~~
- (b) a revised value for the adjustment for items subject to DPCR5 IQI Incentive Rates for the licensee by 30 November 2017 for the purpose of determining the value of RIREV by 30 November 2017-; ~~and~~

(c) a revised value for the adjustment for items subject to to DPCR5 IQI Incentive Rates for the licensee by 30 November 2018 for the purpose of determining the value of RIREV by 30 November 2018.

16.38 A revised value for the adjustment for items subject to DPCR5 IQI Incentive Rates may also be determined by the Authority by 30 November ~~2018~~ 2019 for the purpose of determining the value of RIREV by 30 November ~~2018~~2019, if that is necessary to take account of:

- (a) any requirement for the licensee to restate the values referred to in paragraph 16.26; or
- (b) a revision to any of the adjustment values referred to in paragraphs 16.28 to 16.33.

16.39 No further revisions to the value for the adjustment for items subject to DPCR5 IQI Incentive Rates for the licensee will be determined after 30 November 201~~9~~8 for the purpose of determining a revised value of RIREV, but this is without prejudice to any requirement for the licensee to restate values referred to in this subsection for any other purpose.

## ii) DPCR5 High Value Projects - failure to deliver outputs adjustment

16.40 This subsection sets out the methodology for determining adjustments to the licensee's allowed revenue for RIIO-ED1 in respect of a failure to deliver outputs relating to DPCR5 High Value Projects.

16.41 The term DPCR5 High Value Project means a project identified as such in this subsection, in subsection ix) of section 2 in chapter 15, or in reference documents 1, 2, 3 and 4.

### **Determination of the DPCR5 High Value Projects - failure to deliver outputs adjustment**

16.42 The DPCR5 High Value Projects - failure to deliver outputs adjustment value is derived in accordance with paragraphs ~~15.190~~15.191 to ~~15.200~~15.201 in chapter 15.

16.43 No revised DPCR5 High Value Projects - failure to deliver outputs adjustment value for the licensee will be determined by the Authority:

- (a) by 30 November 2015 for the purpose of determining the value of RIREV by 30 November 2015; or
- (b) by 30 November 2016 for the purpose of determining the value of RIREV by 30 November 2016.

16.44 If, under the methodology set out in subsection ix) of section 2 in chapter 15, the Authority decides that a DPCR5 High Value Projects - failure to deliver outputs adjustment should be included in the calculation of a revised RIREV value for the licensee, then the Authority will determine a revised DPCR5 High Value Projects - failure to deliver outputs adjustment value for the licensee by 30 November 2018 for the purpose of determining the value of RIREV by 30 November 2018.

16.45 If, under the methodology set out in subsection ix) of section 2 in chapter 15, the Authority decides that a DPCR5 High Value Projects - failure to deliver outputs adjustment should be included in the calculation of a revised RIREV value for the licensee, then the Authority will determine a revised DPCR5 High Value Projects - failure to deliver outputs adjustment value for the licensee by 30 November 2017 for the purpose of determining the value of RIREV by 30 November 2017.

16.46 No further revisions to the DPCR5 High Value Projects - failure to deliver outputs adjustment value for the licensee will be determined after 30 November 2018 for the purpose of determining a revised value of RIREV.

### iii) DPCR5 Network Output Measures - failure to deliver outputs adjustment

16.47 This subsection sets out the methodology for determining adjustments to the licensee's allowed revenue for RIIO-ED1 in respect of a failure to deliver outputs relating to DPCR5 Network Output Measures.

16.48 The term DPCR5 Network Output Measure means a measure referred to in reference documents 1, 2 and 4 and which will be further clarified in the DPCR5 Network Output Measures Closeout Methodology.

16.49 The Authority will determine the DPCR5 Network Output Measures Closeout Methodology by 31 March 2016, which it will apply when determining adjustments to the licensee's allowed revenue for RIIO-ED1 in respect of a failure to deliver outputs relating to DPCR5 Network Output Measures.

16.4916.50 By 31 March 2016, the Authority will modify this handbooks so that it sets out a detailed method (the "DPCR5 Network Output Measures – failure to deliver outputs adjustment methodology") for assessing a failure to deliver outputs relating to DPCR5 Network Output Measures, in accordance with CRC 4A (Governance of ED1 Price Control Financial Instruments).

16.5016.51 In determining the DPCR5 Network Output Measures Closeout Methodology, the Authority will take into account the following, without limitation:

- (a) reference documents 1, 2 and 4;
- (b) the network output commitments agreed by the licensee at the outset of DPCR5;
- (c) the principle that any reduced output volumes, with respect to each relevant output unit type referred to in applicable Regulatory Instructions and Guidance, should result from efficient decisions by the licensee that were in the interests of customers;
- (d) information on outputs achieved, submitted by the licensee under relevant Regulatory Instructions and Guidance;
- (e) additional information provided by the licensee covering:
  - updates to assumptions used in setting network output requirements including, for example, assumptions about the pre-existing (ie at the outset of DPCR5) condition of assets;
  - changes to output assessment techniques and calculation methodologies;
  - external factors including economic conditions, planning requirements and resource constraints; and
  - management actions taken in light of evolving risk evaluations, having due regard to any output assessment processes developed by Ofgem, with the participation of the licensee, during DPCR5 or RIIO-ED1;

- (f) developments in the Network Output Measures RIGs reporting during DPCR5; and
- (g) developments in the Network Output Measures risk points analysis for measuring delivery of the Network Output Measures deliverables during DPCR5.

~~16.51~~16.52 After 31 July 2016, the Authority will commence an outputs performance assessment with respect to the licensee, in accordance with chapter 19 and appendix 7 of reference document 2 and as further clarified by the DPCR5 Network Outputs Measures Closeout Methodology. The purpose of the assessment is to determine whether any network outputs gap has arisen which should lead to a downward adjustment to the licensee's allowed revenue (a DPCR5 Network Output Measures - failure to deliver outputs adjustment).

~~16.52~~16.53 In carrying out the assessment referred to in paragraph ~~16.52~~16.51, the Authority will have regard to the scope of its separate performance assessment with respect to DPCR5 High Value Projects outputs (see subsection ii)) to ensure that:

- (a) all output performance is reviewed; and
- (b) the mutual exclusivity of adjustments in respect of DPCR5 High Value Projects and DPCR5 Network Output Measures is observed.

~~16.53~~16.54 Having carried out the assessment described in paragraphs ~~16.52~~16.51 and ~~16.53~~16.52, the Authority will reach a preliminary view on any outputs gap that has arisen. If the Authority's view is that no outputs gap has arisen, then no further action with respect to a DPCR5 Network Output Measures - failure to deliver outputs adjustment will be taken.

~~16.54~~16.55 If the Authority's view is that an outputs gap has arisen, then it will value the outputs gap for each Regulatory Year in DPCR5 in accordance with the DPCR5 Network Output Measures Closeout Methodology.

~~16.55~~16.56 The Authority will then

- (a) multiply the values referred to in paragraph ~~16.55~~16.54 by the DPCR5 IQI Incentive Rate for the licensee multiplied by a factor of 1.025;
- (b) apply DPCR5 Time Value of Money Adjustments to the values calculated under subparagraph (a) to put them on a common 2015/16 time value basis and then total the values for the whole of DPCR5; and
- (c) multiply the total value calculated under subparagraph (b) by minus 1, so that it is a negative value.

~~16.56~~16.57 If the Authority forms a preliminary view that a network outputs gap has arisen and it has valued that gap under paragraph ~~16.55~~16.54 and calculated a possible adjustment value under paragraph ~~16.56~~16.55, it will apprise the licensee of its preliminary view and allow the licensee at least 28 days in which to provide comments before initiating a consultation under paragraph ~~16.58~~16.57.

~~16.57~~16.58 Having considered any comments received from the licensee under paragraph ~~16.57~~16.56, the Authority will, by 31 March 2017, initiate a consultation

with the licensee, network users, suppliers and other stakeholders. The Authority will allow at least two months after the publication of its consultation for the submission of any information that respondents consider should be taken into account in relation to its view.

~~16.58~~16.59 Where applicable, having considered any information received in response to its consultation, the Authority will, by 31 July 2017, decide whether any DPCR5 Network Output Measures - failure to deliver outputs adjustment should be included in the calculation of a revised RIREV value for the licensee. In making its decision, the Authority will apply the DPCR5 Network Outputs Measures Closeout Methodology.

~~16.59~~16.60 If the Authority decides that a DPCR5 Network Output Measures - failure to deliver outputs adjustment should be applied it will give the licensee at least 28 days' notice of its decision and take into account any representations made by the licensee during that period, before including a value in the calculation of a revised RIREV value for the licensee.

### **Determination of the DPCR5 Network Output Measures - failure to deliver outputs adjustment**

~~16.60~~16.61 No revised DPCR5 Network Output Measures - failure to deliver outputs adjustment value for the licensee will be determined by the Authority by 30 November 2015 for the purpose of determining the value of RIREV by 30 November 2015.

~~16.61~~16.62 No revised DPCR5 Network Output Measures - failure to deliver outputs adjustment value for the licensee will be determined by the Authority by 30 November 2016 for the purpose of determining the value of RIREV by 30 November 2016.

~~16.62~~16.63 If, under the methodology set out in this subsection, the Authority decides that a DPCR5 Network Output measures - failure to deliver outputs adjustment should be included in the calculation of a revised RIREV value for the licensee, then the Authority will determine a revised DPCR5 Network Output Measures - failure to deliver outputs adjustment value for the licensee by 30 November 2017 for the purpose of determining the value of RIREV by 30 November 2017.

~~16.63~~16.64 No further revisions to the DPCR5 Network Output Measures - failure to deliver outputs adjustment value for the licensee will be determined after 30 November 2018 for the purpose of determining a revised value of RIREV.

### **(iv) DPCR5 Rising and Lateral Mains - adjustment relating to the level of customer contributions**

#### *References:*

- i. Chapters 2 of reference document 1 specified at the start of this chapter
- ii. Chapter 7 and Appendix 6 of reference document 3 specified at the start of this chapter

~~16.64~~16.65 This subsection sets out the methodology for determining the adjustment to the licensee's allowed revenue for RIIO-ED1 relating to the level of customer contributions for DPCR5 Rising and Lateral Mains. It only applies to SP Distribution plc and SP Manweb plc and only applies directly to the portion of contribution amounts attributable to DPCR5 Slow Money expenditure.

~~16.65~~16.66 The term DPCR5 Rising and Lateral Mains means the mains that carry electricity to individual dwellings within larger premises connected to a public electricity network (for example individual flats within a block of flats), in the context of this subsection and chapter 2 of reference document 1 and chapter 7 of reference document ~~73~~.

### **Calculation of DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions**

~~16.66~~16.67 In setting the licensee's DPCR5 expenditure allowances for work on Rising and Lateral Mains, the Authority used an assumption that the licensee would receive no contributions from customers. The actual amount of customer contributions for Rising and Lateral Mains received by the licensee for each Regulatory Year in DPCR5 are due to be reported by the licensee by 31 July 2015 under applicable Regulatory Instructions and Guidance.

~~16.67~~16.68 The Authority will review the reported values and will use them to calculate the DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions value for the licensee.

~~16.68~~16.69 The following steps are carried out to calculate the DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions:

- (i) The actual amount of customer contributions for Rising and Lateral Mains will be obtained in 2012/13 prices and expressed as a negative value for each Regulatory Year in DPCR5.
- (ii) The values obtained at step (i) will be multiplied by 85 percent.

#### *Calculation of intended incentive effect*

- (iii) The values obtained at step (i) for each Regulatory Year of DPCR5 will be multiplied by the RLM Adjusted Incentive Rate for the licensee.
- (iv) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (iii) to put them on a common 2015/16 time value basis and the values will then be totaled to give the intended incentive effect amount, where a positive value represents an amount that is due to be recouped for consumers.

#### *Calculation of revenue effect that the licensee can be considered to have experienced during DPCR5*

- (v) The values obtained at step (ii) are used to calculate a notional value attributable to:



- (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20); and
  - (b) return, at the WACC for DPCR5 (applied to the NNRRB),
- in respect of the customer contributions for each Regulatory Year in DPCR5.
- (vi) The values calculated at steps (v)(a) and (b) will be summed for each Regulatory Year in DPCR5.
  - (vii) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (vi) to put them on a common 2015/16 time value basis and the values will then be totalled to give the revenue effect that the licensee can be considered to have experienced, where a negative value represents a benefit enjoyed by the licensee.
- Calculation of DPCR5 Rising and Lateral Mains - adjustment relating to the level of customer contributions*
- (viii) The value calculated at step (iv) will be deducted from the value calculated at step (vii).
  - (ix) Any provisional adjustment for the DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (viii).

~~16.69~~16.70 The value obtained at step (ix) in paragraph ~~16.69~~16.68 is the DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions for the licensee.

#### **Determination of the DPCR5 Rising and Lateral Mains - adjustment relating to the level of customer contributions**

~~16.70~~16.71 The Authority will determine a revised DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions value for the licensee for the licensee by 30 November 2015.

~~16.71~~16.72 Subject to paragraphs ~~16.73~~16.72 and ~~16.74~~16.73, the Authority will determine a revised DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions value for the licensee if, with respect to the values referred to in paragraph ~~16.70~~16.70:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality it had attached to those values with regard to a possible restatement requirement (see also paragraph 1.17 in chapter 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

~~16.72~~16.73 A revised DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions value for the licensee may be determined by the Authority:

- (a) by 30 November 2016 for the purpose of determining the value of RIREV by 30 November 2016; and
- (b) by 30 November 2017 for the purpose of determining the value of RIREV by 30 November 2017.

~~16.73~~**16.74** No further revisions to the DPCR5 Rising and Lateral Mains adjustment relating to the level of customer contributions value for the licensee will be determined after 30 November 2017 for the purpose of determining a revised value of RIREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~16.70~~ for any other purpose under any provision of the licence.

### **(v) DPCR5 Workforce Renewal - adjustment resulting from overspend or underspend against allowance**

#### *References:*

- i. Chapters 2 and 4 of reference document 3 specified at the start of this chapter

~~16.74~~**16.75** This subsection sets out the methodology for determining the adjustment to the licensee's allowed revenue for RIIO-ED1 relating to any overspend or underspend against its expenditure allowances for DPCR5 Workforce Renewal. The adjustment relates only to the capitalised portions of expenditure allowances and actual expenditure amounts.

~~16.75~~**16.76** The term DPCR5 Workforce Renewal means the replacement of staff in the circumstances, and for the reasons, set out in chapters 2 and 4 of reference document 3 specified at the start of this chapter and further clarified in RIGs. The costs associated with DPCR5 Workforce Renewal include relevant employee costs and costs for associated activities such as recruitment and training.

~~16.76~~**16.77** The licensee's expenditure allowances for DPCR5 Workforce Renewal are set out against its name in Table 16.3 below.

**Table 16.3 - Opening expenditure allowances for DPCR5 Workforce Renewal (£m in 2012/13 prices)**

Licensee <sup>39</sup>	Regulatory Year				
	2010/11	2011/12	2012/13	2013/14	2014/15

<sup>39</sup> Acronyms refer to the Electricity Distribution Network Operators as set out in paragraph 1A. 7 of CRC 1A.

ENWL	5.69	5.87	5.77	5.35	4.69
NPgN	0.78	1.59	2.16	2.46	2.46
NPgY	1.27	2.52	3.54	3.96	3.96
<del>WMID</del>	<del>2.84</del>	<del>3.64</del>	<del>3.95</del>	<del>4.18</del>	<del>4.00</del>
<del>EMID</del>	<del>2.86</del>	<del>3.66</del>	<del>3.98</del>	<del>4.21</del>	<del>4.03</del>
<del>SWALES</del>	<del>3.44</del>	<del>4.16</del>	<del>3.46</del>	<del>2.46</del>	<del>1.46</del>
<del>SWEST</del>	<del>4.92</del>	<del>5.95</del>	<del>4.94</del>	<del>3.52</del>	<del>2.09</del>
LPN	3.53	3.53	2.76	3.31	3.53
SPN	4.53	4.19	3.86	3.75	3.86
EPN	6.32	6.65	5.54	5.65	5.98
SPD	1.03	1.34	4.33	4.44	4.61
SPMW	1.31	1.64	5.30	5.18	5.27
SSEH	1.58	1.58	1.58	1.58	1.58
SSES	3.04	3.04	3.04	3.04	3.04

~~16.77~~16.78 The licensee's actual expenditure amounts for DPCR5 Workforce Renewal are due to be reported by the licensee by 31 July 2015 under applicable Regulatory Instructions and Guidance.

~~16.78~~16.79 The Authority will review the reported values and will use them to calculate the DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance for the licensee.

#### **Calculation of DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance**

~~16.79~~16.80 The following steps will be carried out to calculate the DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance:

- (i) The licensee's overall opening expenditure allowance will be obtained for each Regulatory Year in DPCR5 in 2012/13 prices from Table 16.3 above and will be multiplied by 85 percent to calculate the DPCR5 Slow Money element.
- (ii) The licensee's actual expenditure amount for each Regulatory Year in DPCR5 will be obtained from the licensee's submissions under relevant Regulatory Instructions and Guidance and will be restated in 2012/13 prices and will then be multiplied by 85 percent to calculate the DPCR5 Slow Money element.
- (iii) The values calculated at step (i) will be deducted from the values calculated at step (ii) to calculate an over or underspend value relating to DPCR5 Slow Money expenditure for each Regulatory Year in DPCR5 in 2012/13 prices.
- (iv) The values calculated at step (iii) will be totalled to calculate an overall over or underspend value relating to DPCR5 Slow Money expenditure for DPCR5 in 2012/13 prices.
- (v) If the value calculated at step (iv) is a positive value (an overall overspend), then steps (vii) to (xiii) will be carried out and steps (xiv) to (xxi) below will not apply.
- (vi) If the value calculated at step (iv) is a negative value (an overall underspend), then steps (xiv) to (xviii) below will be carried out and steps (vii) to (xiii) below will not apply.

Calculation of adjustment in event of overall overspend

*Calculation of intended incentive effect*

- (vii) The values calculated at step (iii) will be multiplied by the Adjusted DPCR5 IQI Incentive Rates for the licensee.
- (viii) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (vii) to put them on a common 2015/16 time value basis and the values will then be totalled to give the intended incentive effect amount.

*Calculation of incentive loss experienced by the licensee during DPCR5*

- (ix) The values calculated at step (iii) will be used to calculate a notional value attributable to:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20);  
and
  - (b) return, at the WACC for DPCR5 (applied to the NNRRB),in respect of the licensee's overspend for each Regulatory Year in DPCR5.

- (x) The values calculated at steps (ix)(a) and (b) will be summed for each Regulatory Year in DPCR5.
- (xi) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (x) to put them on a common 2015/16 time value basis and the values will then be totalled.

*Calculation of DPCR5 Workforce Renewal adjustment*

- (xii) The value calculated at step (viii) will be deducted from the value calculated at step (xi).
- (xiii) Any provisional adjustment for the DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (xii).

Calculation of adjustment in event of overall underspend

*Calculation of incentive gain experienced by the licensee during DPCR5*

- (xiv) The values calculated at step (iii) will be split into:
  - (a) DPCR5 Slow Money amounts (being 85 percent); and
  - (b) DPCR5 Fast Money amounts (being 15 percent).
- (xv) The values calculated at step (xiv)(a) will be used to calculate a notional value attributable to:
  - (a) an amount of depreciation (being annual values calculated as the applicable value divided by 20);  
and
  - (b) return, at the WACC for DPCR5 (applied to the NNRRB),  
in respect of the licensee's underspend for each Regulatory Year in DPCR5.
- (xvi) The values calculated at steps (xiv)(b) and (xv)(a) and (b) will be summed for each Regulatory Year in DPCR5.
- (xvii) DPCR5 Time Value of Money Adjustments will be applied to the values calculated at step (xvi) to put them on a common 2015/16 time value basis and the values will then be totalled.
- (xviii) Any provisional adjustment for the DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance that was included in the calculation of the licensee's Opening Base Revenue Allowances will be deducted from the value calculated at step (xvii).

~~16.80~~16.81 The value obtained at:

- (a) step (xiii); or, as applicable,

(b) step (xviii) (which can only be a negative value) in paragraph ~~16.80~~~~16.79~~9,

is the DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance for the licensee in 2012/13 prices.

### **Determination of the DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance**

~~16.81~~~~16.82~~ The Authority will determine a revised DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance value for the licensee by 30 November 2015.

~~16.82~~~~16.83~~ Subject to paragraphs ~~16.84~~~~16.83~~3 and ~~16.85~~~~16.84~~4, the Authority will determine a revised DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance value for the licensee if, with respect to the values referred to in paragraph ~~16.78~~~~16.77~~7:

- (a) the Authority apprised the licensee, by 31 October 2015, of any provisionality it had attached to those values with regard to a possible restatement requirement (see also paragraph 1.17 in chapter 1); or
- (b) the licensee is required, under any provision of the licence to restate any of those values.

~~16.83~~~~16.84~~ A revised DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance value for the licensee may be determined by the Authority:

- (a) by 30 November 2016 for the purpose of determining the value of RIREV by 30 November 2016; and
- (b) by 30 November 2017 for the purpose of determining the value of RIREV by 30 November 2017.

~~16.84~~~~16.85~~ No further revisions to the DPCR5 Workforce Renewal adjustment resulting from overspend or underspend against allowance value for the licensee will be determined after 30 November 2017 for the purpose of determining a revised value of RIREV, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph ~~16.78~~~~16.77~~ for any other purpose under any provision of the licence.

### **Section 3 – Determination of revisions to the PCFM Variable Value for legacy adjustments associated with the DPCR5 RAV Rolling Incentive mechanism (the RIREV value)**

~~16.85~~~~16.86~~ This section sets out the methodology by which the Authority will determine the value of RIREV for the licensee for the purpose of directing any revisions to that value under section 4, and in accordance with Part D of CRC 3A.

~~16.86~~16.87 The Authority will determine the value of RIREV for the licensee by 30 November in each Regulatory Year from 2015/16 to 2021/22, by summing the most recently determined values for each of the five adjustments set out in Table 2 in CRC3A.

~~16.87~~16.88 Timings for the determination of each adjustment are set out in the respective subsections of this section. ~~Table 16.4 below, summarises these timings, indicating for each determination of the RIREV value, the adjustment values that are liable to have changed since the previous determination.~~

**Table 16.4—Timings for determination of adjustments comprising the RIREV value**

<b>Adjustment</b>	<b>Provision for determination of revised adjustment value by</b>							
	<b>30-Nov 2015</b>	<b>30-Nov 2016</b>	<b>30-Nov 2017</b>	<b>30-Nov 2018</b>	<b>30-Nov 2019</b>	<b>30-Nov 2020</b>	<b>30-Nov 2021</b>	<b>30-Nov 2022</b>
<del>Adjustment for items subject to the DPCR5 IQI Incentive Rates for the licensee</del>	<del>yes</del>	<del>yes</del>	<del>yes</del>	<del>possible</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>
<del>DPCR5 High Value Projects—failure to deliver outputs adjustment</del>	<del>no</del>	<del>no</del>	<del>yes</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>
<del>DPCR5 Network Output Measures—failure to deliver outputs adjustment</del>	<del>no</del>	<del>yes</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>
<del>DPCR5 Rising and Lateral Mains—adjustment relating to the level of customer contributions</del>	<del>yes</del>	<del>possible</del>	<del>possible</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>
<del>DPCR5 Workforce Renewal—adjustment resulting from overspend or underspend against allowances</del>	<del>yes</del>	<del>possible</del>	<del>possible</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>	<del>no</del>



~~16.88~~16.89 The RIREV value is only contained in the column for Regulatory Year 2015/16 in the PCFM Variable Values Table for the licensee. The opening value of RIREV for the licensee, as at 1 April 2015, will be zero (see also paragraph 13.7 in chapter 13). Functionality within the PCFM means that the change to the licensee's revenue allowance, represented by the RIREV value, is spread across recalculated base revenue figures for the whole Price Control Period with appropriate Time Value of Money Adjustments.

~~16.89~~16.90 Determinations of the RIREV value for the licensee will be in 2012/13 prices.

#### **Section 4 – Direction of revisions to the RIREV value**

~~16.90~~16.91 Paragraph 3A.34 of CRC 3A requires the Authority to give the licensee at least 14 days' notice setting out any proposed revision to the RIREV value that it has determined, before directing the revision. This means that the Authority will give notice to the licensee of any revision 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.

~~16.91~~16.92 Having complied with the notice requirements, the Authority will direct any required revision to the RIREV value by 30 November in each Regulatory Year t-1.

##### *Delay in direction of revised RIREV Value*

~~16.92~~16.93 If, for any reason, the Authority does not give a required direction of a revision to the RIREV value by 30 November in any Regulatory Year t-1, CRC 3A requires that the value 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 CRC 4B (Annual Iteration Process for the PCFM).

## Appendix 1 - Glossary

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### A

#### Adjusted DPCR5 IQI Incentive Rate (see also DPCR5 IQI Incentive Rate)

Means the percentage values for the licensee set out in the table below.

<b>Licensee</b>	<b>Incentive rate for 2010/11</b>	<b>Incentive rate for 2011/12 to 2014/15</b>
Electricity North West Ltd	35.29%	35.29%
Northern Powergrid (Northeast) Limited	38.82%	38.82%
Northern Powergrid (Yorkshire) plc	38.82%	38.82%
<del>Western Power Distribution (West Midlands) plc</del>	<del>37.65%</del>	<del>40.00%</del>
<del>Western Power Distribution (East Midlands) plc</del>	<del>37.65%</del>	<del>40.00%</del>
<del>Western Power Distribution (South Wales) plc</del>	<del>42.35%</del>	<del>40.00%</del>
<del>Western Power Distribution (South West) plc</del>	<del>42.35%</del>	<del>40.00%</del>
London Power Networks plc	35.29%	35.29%
South Eastern Power Networks plc	35.29%	35.29%
Eastern Power Networks plc	35.29%	35.29%
SP Distribution plc	35.29%	35.29%
SP Manweb plc	35.29%	35.29%
Scottish Hydro Electric Power Distribution plc	40.00%	40.00%
Southern Electric Power Distribution plc	40.00%	40.00%

#### Adjusted RLM Incentive Rate

Means -5.88 percent.

#### Affiliate

Has the meaning given in Standard Condition 1 (Definitions for the standard conditions) of the electricity distribution licence.

## Annual Iteration Process

The Annual Iteration Process is the process set out in CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model) 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.

## B

### Base Annual PSED Allowance

For the purposes of chapter 3 of this handbook, means an allowance derived in accordance with the formulae set out in row 7 of Tables 3.2 and 3.3 in chapter 3 and excludes the components of total PSED revenue allowances that relate to:

- the licensee's under/over-payment history;
- the application of adjustment factors resulting from Reasonableness Reviews; and
- any adjustment due in respect of the true up of forecast costs to actual costs for ongoing pension costs in Regulatory Year 2009/10.

### Base Demand Revenue ( $BR_t$ )

The amount included in the licensee's Allowed Distribution Network Revenue for a particular Regulatory Year, that is derived in accordance with the formula set out in paragraph 2A.5 of CRC 2A (Restriction of Allowed Distribution Network Revenue).

## C

### Contingent Asset

For the purposes of the methodology in chapter 3 of this handbook, 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/prevaling 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**

### Decimal Percentage

For the purposes of chapter 5 of this handbook, means a percentage value expressed in decimal format so that, for example, five percent (5%) expressed as a Decimal Percentage is 0.05 and twenty percent (20%) expressed as a Decimal Percentage is 0.2.

### Defined Benefit Scheme

A pension scheme where the benefits that accrue to members are normally based on a set formula taking into account the member's salary levels and accrual of service in the 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.

### Distribution Services Provider

Has the meaning given in Standard Condition 1 of the electricity distribution licence.

### Distribution Services Area

Has the meaning given in Standard Condition1 of the electricity distribution licence.

### DPCR4 Price Control / DPCR4

Means the electricity distribution price control arrangements applicable from 1 April 2005 until 31 March 2010.

### DPCR5 Price Control / DPCR5

Means the electricity distribution price control arrangements applicable from 1 April 2010 until 31 March 2015 that preceded RIIO-ED1.

### DPCR5 Enhanced Physical Site Security and Black Start

In this handbook has the meaning given in subsection x) in section 2 of chapter 15.

### DPCR5 Equalised Incentive

In this handbook, means the equalised incentive described in chapter 21 of the DPCR5 Electricity Distribution Price Control Review Final Proposals - Incentives and Obligations document.

### DPCR5 Fast Money

In this handbook means amounts:

- representing 15 percent of the costs subject to the DPCR5 Equalised Incentive; and
- business support costs, non-operational capex and traffic management costs (excluding administration costs),

that, with respect to baseline expenditure allowances, were included in the determination of DPCR5 Revenue Allowances for the licensee for the year of expected expenditure.

### DPCR5 Financial issues Data Tables

The data tables of that name referred to in the RIGs applicable to the licensee in the DPCR5 Price Control Period.

### ~~DPCR5 High Value Projects Re-opener Closeout Detailed Methodology~~

~~Has the meaning given in paragraph **Error! Reference source not found.** of this handbook.~~

### DPCR5 IQI Incentive Rate (see also Adjusted DPCR5 IQI Incentive Rate)

Means the incentive rate(s) for the licensee set out in the table at Appendix 1 to Special Condition CRC 18 (Arrangements for the recovery of uncertain costs) of the licence in the form that it was in on 31 March 2015. The incentive rates are reproduced below.

Licensee	Incentive rate for 2010/11	Incentive rate for 2011/12 to 2014/15
Electricity North West Ltd	45%	45%
Northern Powergrid (Northeast) Limited	48%	48%
Northern Powergrid (Yorkshire) plc	48%	48%
<del>Western Power Distribution (West Midlands) plc</del>	<del>47%</del>	<del>49%</del>
<del>Western Power Distribution (East Midlands) plc</del>	<del>47%</del>	<del>49%</del>

<del>Western Power Distribution (South Wales) plc</del>	<del>51%</del>	<del>49%</del>
<del>Western Power Distribution (South West) plc</del>	<del>51%</del>	<del>49%</del>
London Power Networks plc	45%	45%
South Eastern Power Networks plc	45%	45%
Eastern Power Networks plc	45%	45%
SP Distribution plc	45%	45%
SP Manweb plc	45%	45%
Scottish Hydro Electric Power Distribution plc	49%	49%
Southern Electric Power Distribution plc	49%	49%

#### DPCR5 Load related Re-opener Closeout Detailed Methodology

Has the meaning given in paragraph ~~15.111~~~~15.112~~ of this handbook.

#### DPCR5 Network Output Measure

Means a measure referred to in subsection iii) in section 2 in chapter 16 of this handbook and described in reference documents 1, 2 and 4 specified at the start of that chapter.

#### DPCR5 Price Control / DPCR5

Means the electricity distribution price control arrangements applicable from 1 April 2010 until 31 March 2015 that immediately preceded RIIO-ED1.

#### DPCR5 RAV Rolling Incentive

Means the incentive mechanism described in section 1 of chapter 16 of this handbook.

#### DPCR5 Revenue Allowance

In this handbook means the PU value sets against the licensee's name in Appendix 1 to Special-Charge restriction 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 Slow Money

In this handbook, means 85 percent of expenditure on costs subject to the equalised incentive described in chapter 21 of the DPCR5 Electricity Distribution Price Control Review Final Proposals - Incentives and Obligations document.

### 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 percent; and
- Y represents the number of years over which the DPCR5 Time Value of Money Adjustment is to be applied.

### ~~DPCR5 Traffic Management Permit Costs Closeout Detailed Methodology~~

~~Has the meaning given in paragraph of this handbook.~~

## E

### Early Retirement Deficiency Contributions (ERDCs)

The cost of providing enhanced pension benefits granted under severance arrangements prior to 1 April 2004.

### ED1 Price Control Financial Instruments

The collective term for the ED1 Price Control Financial Handbook and the ED1 Price Control Financial Model.

### ED1 Price Control Financial Model Working Group

The working group whose terms of reference are set out in section 3 of chapter 1 of this handbook.

### ED1 Price Control Financial Methodologies

The methodologies set out in sections 2 and 3 of this handbook that form part of CRC 4A (Governance of ED1 Price Control Financial Instruments) and that are used to determine revised PCFM Variable Values.

### ED1 Price Control Financial Model (PCFM)

The model of that name (with a suffix referring to the month of November in Regulatory Year t-1 as that term is defined for the purposes of CRC 4A) that:

- (a) came into effect on 1 April 2015;

- (b) is represented by a workbook in Microsoft Excel ® format maintained under that name (with a Regulatory Year suffix) on the Authority's website; and
- (c) will be used by the Authority to determine the value of the term  $MOD_t$  through the application of the Annual Iteration Process,

as modified from time to time in accordance with the provisions of CRC 4A (Governance of ED1 Price Control Financial Instruments).

#### Electricity Distribution Network Operator

In this handbook has the same meaning as Distribution Services Provider.

#### Enhanced Physical Site Security Costs

Has the meaning given in CRC 3F (Arrangements for the recovery of uncertain costs) - but see also DPCR5 Enhanced Physical Site Security and Black Start.

#### ENWL

Means Electricity North West Ltd.

#### EPN

Means Eastern Power Networks plc.

#### F

##### Fast Money

For RIIO-ED1 means:

- allowance adjustments that flow directly into recalculated base revenue figures for the licensee for RIIO-ED1; and
- 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  $(1 - \text{Totex Incentive Strength Rate})$ .

#### G

##### Gearing

In this handbook means the licensee's net debt balance divided by its RAV balance at the time or for the period of time in question.

#### H



[High Value Projects Re-opener Legacy Assessment Methodology](#)

[Has the meaning given in Chapter 15 of this handbook.](#)

**I**

International Financial Reporting Standards (IFRS)

Accounting standards set by the International Accounting Standards board.

Internal Rate of Return

For the purposes of subsection iii) of section 2 of chapter 15 of this handbook, means the percentage rate, which if used as a discount rate with respect to cashflows would give a net present value of zero, where the cashflows are:

- the projected revenue streams; and
- the total of Use of System Capex amounts (before application of the pass through rate) in nominal prices and as a negative value.

**L**

Link Box

Has the meaning given in CRC 3F.

[Load-related Reopener Legacy Assessment Methodology](#)

[Has the meaning given in Chapter 15 of this Handbook.](#)

LPN

Means London Power Networks plc.

**M**

March/April RPI Factor for a Regulatory Year

Means a value calculated as:

the arithmetic average of the Retail Prices Index (all items) published by the Office for National Statistics for the month of March in the Regulatory Year concerned and the next month of April, rounded to three decimal places;

divided by

the arithmetic average of the Retail Prices Index (all items) published by the Office for National Statistics for each month of the Regulatory Year concerned, rounded to three decimal places.

## MOD

The term of that name included in the formula for Base Demand Revenue set out in CRC 2A (Restriction of Allowed Distribution Network Revenue). 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 CRC 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

### Net Tax Pool Movements

Means the change from the closing balance reported for a tax pool as at the end of one Regulatory Year and the closing balance for the same tax pool as at the end of the next Regulatory Year, being the sum of:

- net additions to the pool during the year,
- the amount of any revision to the first year's closing balance, and
- the amount (as a negative value) of applicable writing down allowances.

## NINES

Means the Northern Isles New Energy Solution (Shetland trial)

## NNRRB

(see NPV Neutral RAV Return Base)

## Notice

Has the meaning given in Standard Condition1 of the electricity distribution licence.

## NPgN

Means Northern Powergrid (Northeast) Limited.

## NPgY

Means Northern Powergrid (Yorkshire) plc.

## NPV Neutral RAV Return Base (NNRRB)

In this handbook means a value calculated as the arithmetic average of:

- (a) the opening RAV balance (or notional RAV balance for the calculation in question); and
- (b) the closing RAV balance (or notional RAV balance for the calculation in question), discounted by a factor calculated as

$$\frac{1}{1+WACC}$$

for the Regulatory Year referred to in the same instance.

## O

### Ofgem Website

The website at the URL: [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

### Ongoing Pension Service Costs (OPSC)

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

### Opening Base Revenue Allowance

The amount in 2012/13 prices, represented by the term  $PU_t$ , included in the licensee's Base Demand Revenue for a particular Regulatory Year that is set down against the licensee's name in the table at Appendix 1 to CRC 2A (Restriction of Allowed Distribution Network Revenue).

## P

### PCFM Variable Value

means a value held in the PCFM Variable Values Table for the licensee contained in the ED1 Price Control Financial Model:

- (a) that may be revised by a direction of the Authority following a determination under the relevant CRC; but
- (b) the revision of which does not constitute a modification of the ED1 Price Control Financial Model for the purposes of CRC 4A.

### PCFM Variable Values Table (for the licensee)

The table of blue shaded cells on the Input worksheet of the ED1 PCFM containing the PCFM Variable Values for the licensee.

### Pension Deficit Allocation Methodology

The methodology of that name contained in the Pension RIGs used by the Authority in the determination of the licensee's Pension Scheme Established Deficit.

### Pension Principles

See paragraph 3.5 in chapter 3.

### 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 the 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 (PSED)

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

- the regulated business; and
- pensionable service up to the end of the cut-off date, which for Electricity Distribution Network Operators is 31 March 2010.

If the Pension Scheme 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 Established Deficit Adj (PSED<sub>ADJ</sub>)

A different value (PSED<sub>ADJ</sub>) substituted for the PSED for the purposes of the methodology in this handbook. The Authority may, following bilateral discussions, agree with the licensee that a different value be substituted for the PSED.

#### Pension Scheme Incremental Deficit (PSID)

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

- the regulated business; and
- pensionable service after the cut-off date, which for Electricity Distribution Network Operators 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 that has been capitalised under regulatory rules. The licensee receives a return and depreciation on its RAV in its price control allowed revenues.

### Real Price Effect

A measure of the expected real input price inflation for the licensee.

### Reasonableness Review

A review by the Authority of the findings of an independent report commissioned by it on the reasonableness of costs associated with the licensee's pension deficit position (but not on the deficit allocation to the PSED) which may lead to further review procedures if the licensee is an outlier with respect to cost levels and that position is:

- (a) to the detriment of consumers; and
- (b) reasonably attributable to the NWO, recognising the responsibilities and independence of pension scheme trustees.

### Regulatory Accounts

Has the meaning given in Standard Condition1 of the electricity distribution licence.

### Regulatory Instructions and Guidance (RIGs)

The collective term for documents issued to licensee [under SLC 45](#) 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 the following 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.

### Related Undertaking

Has the meaning given in Standard Condition 1 (Definitions for the standard conditions) of the electricity distribution licence.

### Relevant Adjustment

For the purposes of chapter 12 of this handbook, has the meaning given in CRC 3D (The Innovation Roll-out Mechanism).

### RIGs

See Regulatory Instructions and Guidance.

### RIIO

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

### RIIO-ED1

The price control arrangements applicable to Electricity Distribution Network Operators from 1 April 2015 until 31 March 2023.

### RIIO-ED2

The price control arrangements that will be applicable to Electricity Distribution Network Operators after 31 March 2023.

## S

### Scheme Valuation Dataset

The items set out in paragraph 3.22 of chapter 3 of this handbook, provided to Ofgem by the licensee in accordance with the Pension RIGs.

### Shetland Integrated Plan and [Shetland] Competitive Process

In this handbook have the meanings given in paragraph [7.73 of this Handbook](#) ~~7.84 and 15.244~~.

### Slow Money

For RIIO-ED1, means the proportion of Totex that is added to the licensee's RAV balance on which the licensee receives a revenue allowance to cover finance (Vanilla WACC) and depreciation costs.

### Smart Meter Installation

Has the meaning given in CRC 3E (Smart Meter Roll-out Costs).

### Smart Meter Intervention

Has the meaning given in CRC 3E.

## SPD

Means SP Distribution plc.

## Specific Customer Funded Reinforcement Percentage Band

Means the band of percentage values specified against the licensee's name in Table 2 of CRC 5G (Net to gross adjustment for Load Related Expenditure).

## SPMW

Means SP Manweb plc.

## LPN

Means South Eastern Power Networks plc.

## SSEH

Means Scottish Hydro Electric Power Distribution plc.

## SSES

Means Southern Electric Power Distribution plc.

## 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

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 Incentive Mechanism (TIM)



TIM is the mechanism under which adjustments are made to reflect differences between the licensee's allowed Totex and actual expenditure. 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 Capitalisation Rate

The percentage values set down against the licensee's name under that heading in Appendix 1 of CRC 3B (Determination of PCFM Variable Values relating to actual Totex expenditure for Totex Incentive Mechanism Adjustments). It is the percentage of Totex which is added to RAV (see also Slow Money).

#### Totex Incentive Strength Rate (TISR)

A percentage figure specified in CRC 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.

#### Traffic Management Permit Costs Legacy Assessment Methodology

Has the meaning given in chapter 15 of this handbook.

#### 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.

#### Use of System Capex

In chapter 15 of this handbook has the meaning given in Special Condition CRC11 of the licence in form it was in on 31 March 2015.

## V

#### Vanilla WACC

See WACC and WACC for DPCR5.

### Visual Amenity Project

Has the meaning given in CRC 3J (Allowed expenditure on Visual Amenity Projects).

## 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.

### WACC for DPCR5

Means 4.69 percent.

### Worst Served Customer

Has the meaning given in CRC 3H (Allowed expenditure on improving services to Worst Served Customers).

### Worst Served Customer Project

Has the meaning given in CRC 3H.