

DPCR5 Close out: Changes to the RIIO-ED1 Financial Handbook

Final decision

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Overview

The fifth electricity distribution price control (DPCR5) ran from 1 April 2010 to 31 March 2015. It had several elements which could not be settled until the price control had ended. We have committed to developing methodologies for assessing a number of these areas.

Following our informal and statutory consultations, this document outlines the changes to the RIIO ED1 Price Control Financial Handbook to incorporate these methodologies. The methodologies apply to all electricity distribution network operators (DNOs).

We will be closing out these mechanisms as part of the 2017 Annual Iteration Process (AIP).

Context

In February 2015, we modified the electricity distribution licences to incorporate arrangements for closing out the fifth electricity distribution price control (DPCR5). These arrangements are governed by special licence condition CRC3A (Legacy price control adjustments) of the electricity distribution licence and Part 3 of the RIIO-ED1 Price Control Financial Handbook (Legacy price control adjustment methodologies).

We already have methodologies in place for closing out most of the remaining DPCR5 mechanisms. However, for five areas, we committed to develop additional detailed methodologies and formally incorporate them into the Financial Handbook after the price control had ended. In accordance with the Handbook we are required to publish our decision on the modifications by 31 July 2016.

The methodologies reflect what was set out in our DPCR5 Final Proposals (DPCR5 FPs) and the Network Outputs Data and Performance Reporting (NADPR) Regulatory Instructions and Guidance (RIGs). The NADPR RIGs were developed in cooperation with the DNOs after DPCR5 Final Proposals (FPs) were published and reflect evolutions in our thinking. In some cases we are proposing changes from DPCR5 FPs to address areas of uncertainty or to provide clarification.

In September and December 2015, we consulted on the proposed changes. In May 2016 we issued an informal consultation on the associated changes to the Handbook. In June we published our statutory consultation alongside our decision on the policy for DPCR5 Close out.

We have considered responses to both the informal consultation and the statutory consultation and are now publishing our decision on the full suite of DPCR5 Close out methodologies to be incorporated into the Handbook. We will be closing out these mechanisms as part of the 2017 Annual Iteration Process (AIP).

Associated documents to this consultation

Documents published alongside this consultation

- Supplementary Annex 1: Changes to Part 3 of the RIIO-ED1 Financial Handbook for the DPCR5 Close out
- Issue Log of changes to the DPCR5 methodologies since statutory consultation

Other relevant documents

- [DPCR5 Final Proposals - Allowed Revenue - Cost Assessment](#)
- [DPCR5 Final Proposals - Incentives and Obligations](#)
- [Network Outputs Data and Performance Reporting \(NADPR\) Regulatory Instructions and Guidance \(RIGs\)](#)
- [Consultation on the methodologies for DPCR5 Close out](#)
- [DPCR5 Close out methodologies - further changes since informal consultation](#)
- [DPCR5 Close out: informal consultation on changes to ED1 Handbook](#)
- [DPCR5 Close out: statutory consultation on changes to the ED1 Handbook](#)
- [DPCR5 Close out: Decision document](#)

Contents

Executive summary	1
1. Introduction	2
Purpose of this document	2
Approach to licence drafting	3
Structure of this document	5
2. Overview of the methodologies	6
DPCR5 Network Output Measures	6
Load Related Re-opener	8
High Value Projects	10
Traffic Management Act Permit Costs	11
Flood prevention costs	13
Performance Assessment Submission	14
3. Responses to the statutory consultation	15
DPCR5 Network Output Measures	15
Load Related Re-opener	16
High Value Projects	17
Traffic Management Act Permit Costs	17
Flood prevention costs	17
Performance Assessment Submission	18
Definitions	18
Other	18
4. Next steps	20
Appendix 1 – Summary of responses	22
Appendix 2 – Financial Handbook structure and proposed modifications	23
Appendix 3 – Feedback questionnaire	25

Executive summary

The fifth electricity distribution price control (DPCR5) ended on 31 March 2015. DPCR5 Final Proposals (DPCR5 FPs) set out the policy for DPCR5. This included setting out the approach and principles for five specific areas where the arrangements could not be settled (closed out) until the price control had ended. We committed at that time to developing more detailed methodologies for assessing the performance of the Distribution Network Operators (DNOs) in these areas.

We have developed the following methodologies to close out five elements (there are two parts for High Value Projects) of DPCR5:

- **Network Output Measures (NOMs)** – a methodology to enable us to assess whether the DNOs have delivered a package of outputs in relation to asset health, asset loading and faults that they committed to deliver at DPCR5 FPs. The methodology enables us to adjust DNOs’ revenue downwards where they have failed to deliver those outputs or equivalent outputs.
- **Load Related Re-opener** – a methodology to enable us to adjust DNOs revenue upwards or downwards depending on whether their expenditure for load growth was materially higher or lower than provided for in allowances at DPCR5 FPs.
- **High Value Projects (HVP) Re-opener** – a methodology to enable us to adjust DNOs revenue upwards or downwards depending on whether their expenditure on specific projects over £15m which they committed to deliver during DPCR5 was materially higher or lower than provided for in allowances at DPCR5 FPs.
- **HVP outputs adjustment** – a methodology to enable us to assess whether DNOs have delivered specific outputs they committed to deliver for HVPs in DPCR5 FPs.
- **A Traffic Management Act Permit Costs reopener** – a methodology to enable DNOs to recover costs incurred for permits when working on roads and highways which were not provided for at DPCR5 FPs; and
- **A Flood Prevention Re-opener** – a methodology which only applies to Scottish and Southern Electricity in its Hydro region in the north of Scotland (SSEH) and allows SSEH to recover money spent on flood prevention that was not in its baseline expenditure allowance for DPCR5.

This document sets out the changes to the RIIO-ED1 Price Control Financial Handbook (the “Handbook”) to incorporate these methodologies. Detail of the changes is set out in supplementary annex 1 published alongside this document.

We have worked with the DNOs to develop these methodologies. We established a Working Group which met from December 2015 to June 2016 and which included representatives from all DNOs and British Gas. We consulted on the content of these methodologies in September 2015 and December 2015 and published our decision on the policy in June 2016. In addition, we published an informal consultation on Handbook drafting in May 2016 and a statutory consultation in June 2016.

This document sets out our decisions on changes to the Handbook following the statutory consultation. The modifications we are publishing today will come into effect 56 days after publication.

1. Introduction

Chapter Summary

This chapter sets out the purpose and structure of the document. It also provides an overview of our approach to DPCR5 Close out and the development of the DPCR5 Close out methodologies.

Purpose of this document

1.1. The previous electricity distribution price control (DPCR5) ran from 1 April 2010 to 31 March 2015. As part of DPCR5, the DNOs committed to delivering specific outputs relating to network investment, and we put in place mechanisms to deal with areas of uncertainty.

1.2. At DPCR5 Final Proposals (DPCR5 FPs) we explained that some of these mechanisms would need to be “closed out” ex-post at RIIO-ED1. These include reopeners which deal with under or overspend, and output mechanisms which enable us to impose a penalty on DNOs if they have not delivered the outputs they originally committed to. Adjustments are made to ED1 allowed revenues.

1.3. We are proposing changes to the Handbook for the purpose of introducing new and clarifying existing methodologies to close out the following five elements of DPCR5:

- DPCR5 Network Output Measures (NOMs): the assessment of delivery against the asset health, loading and Fault Rates deliverables;
- the DPCR5 Load Related Re-opener;
- the expenditure reopener and the assessment of delivery against outputs for High Value Projects;
- the DPCR5 Traffic Management Act Permit Costs reopener; and
- the reopener for DPCR5 Flood Protection expenditure which solely applies to Scottish and Southern Electricity in its Hydro region (SSEH).

1.4. The effect of our proposed methodologies is to clarify how we will assess DNO performance under each mechanism and calculate any associated RIIO-ED1 revenue adjustments.

1.5. The methodologies for closing out these mechanisms could not be finalised as part of the RIIO-ED1 process. We decided to develop and introduce methodologies to

the Handbook at a later stage and amended the licence to this effect on 3 February 2015¹. We are making a decision now to close these out in time for the 2017 AIP.

1.6. We have developed these methodologies specifically within the context of DPCR5. The methodologies are not intended to set a precedent for how we will deal with similar mechanisms in other price controls and in other sectors, though they may be used to inform our approach in the future.

Approach to licence drafting

Working Group

1.7. We created a Working Group comprising members of the Ofgem team, DNO representatives and British Gas. This group has met regularly to review and develop the DPCR5 Close out methodologies. Notes of the meetings of the Working Group are published on our website².

Methodology consultations

1.8. We consulted twice on our approach to closing out DPCR5, in September 2015 (the 'September 2015 consultation') and again in December 2015 (the 'December 2015 consultation'). The consultations and all non-confidential responses are available on our website³.

September 2015 consultation

1.9. This set out high-level draft methodologies. It noted that the methodologies were based on the approach and principles described in DPCR5 FPs. It also noted that in some cases our thinking had evolved during the five years of the price control and highlighted the rationale for the changes.

1.10. In particular, it proposed and sought views on the following approaches:

- NOMs
 - to undertake a quantitative and qualitative assessment of DNO performance rather than just carrying out qualitative assessment of the NOMs;
 - the introduction of a quantitative materiality threshold before making a financial adjustment;

¹ RIIO-ED1: Modifications to the standard conditions of the electricity distribution licences <https://www.ofgem.gov.uk/publications-and-updates/riio-ed1-modifications-standard-conditions-electricity-distribution-licences-0>

² <https://www.ofgem.gov.uk/publications-and-updates/dpcr5-close-out-working-group>

³ <https://www.ofgem.gov.uk/publications-and-updates/consultation-methodologies-dpcr5-close-out>

- not to make changes to the HI NOMs deliverables for Material Changes; and
- not to apply financial adjustments for Fault Rates as we did not consider at the time it was possible to establish a clear link between costs and Fault Rates.
- Load Related Re-opener
 - to avoid double counting between the Load Related Re-opener and Load Indices (LI) NOMs; and
 - to widen the definition of innovation to include smart grids, energy storage or any other innovative technique that the DNOs used to avoid network reinforcement during DPCR5.
- HVPs
 - to avoid double counting between the HVP Re-opener and HVP outputs adjustment;
 - to take into account the fact that projects may be at different stages in their delivery;
 - to develop additional approaches based on four different categories of project to ensure our assessment accurately reflects whether or not outputs have been delivered and the type of projects delivered; and
 - to ensure that any partial delivery of outputs and/or any changes in outputs is reflected in our assessment of whether there is an outputs gap and the valuation of the outputs gap.

1.11. We received seven responses to the September 2015 consultation, none of which were identified as confidential and all of which are published on our website⁴.

December 2015 consultation

1.12. Further to consideration of responses to the September 2015 consultation, we published a further consultation in December 2015 in which we noted we had reconsidered our approach to assessing the NOMs from the position we set out in the September 2015 consultation, in two key respects:

- Material Changes – we outlined our intention to make appropriate adjustments to the agreed outputs to take account of Material Changes in line with the original intent in DPCR5 FPs and the NADPR RIGs.
- Fault Rates – we outlined our intention to monetise Fault Rates as being in line with the original intention of DPCR5 FPs and ensuring a consistent approach to performance assessment for all asset classes where asset replacement or refurbishment expenditure was allowed in DPCR5.

⁴ <https://www.ofgem.gov.uk/publications-and-updates/consultation-methodologies-dpcr5-close-out>

1.13. In addition, having considered the views of respondents, we noted that we proposed to include an additional methodology for assessing the amounts that Scottish and Southern Electricity had spent on flood prevention in its Hydro region in the north of Scotland (SSEH). This was to reflect the policy intention in DPCR5 FPs.

1.14. We received six responses to the December 2015 consultation, five of which were not marked as confidential, while one response was marked as confidential. The five non-confidential responses can be found on our website⁵

DPCR5 Close out Decision

1.15. We published a decision document on DPCR5 Close out (“DPCR5 Close out Decision”) in June 2016 alongside our statutory consultation. The DPCR5 Close out Decision summarised responses to the September 2015 consultation and the December 2015 consultation and set out in detail our final decision on the policy behind the changes to the Handbook which we are publishing today.

Handbook structure

1.16. We have sought to insert any new text at appropriate places within the current Handbook structure. We have not proposed significant changes to the structure of the current Handbook.

1.17. Most of methodologies have been inserted as new annexes to Part 3 of the Handbook (Legacy price control adjustment methodologies). In doing so we are also making changes to the relevant sections of the existing Chapters 15 and 16 of the Handbook. The exception is in relation to the methodology on Flood Prevention which is inserted as a whole into Chapter 15.

Structure of this document

1.18. Chapter 2 sets out further detail of the proposed methodologies. Chapter 3 summarises the key comments we received to our statutory consultation and highlights where we have changed the Handbook drafting in response to those comments. Chapter 4 sets out the next steps in the DPCR5 Close out process. The new structure of the Handbook is outlined in Appendix 2.

1.19. Alongside this document we have published our changes to CRC 3A (Legacy price control adjustments) and the associated Part 3 of the RIIO-ED1 Price Control Financial Handbook, a supplementary annex setting out the changes to of the DPCR5 Close out methodologies. This is implementing the DPCR5 Close out Decision. We have also published a revised version of our Issues Log which sets out all of the comments received as part of the informal and the statutory consultation and how we have addressed these.

⁵ <https://www.ofgem.gov.uk/publications-and-updates/dpcr5-closeout-methodologies-further-changes-informal-consultation>

2. Overview of the methodologies

Chapter Summary

This chapter explains at a high level the methodologies that we are introducing for DPCR5 Close out.

2.1. We set out below a high level summary of the methodologies for DPCR5 Close out. These methodologies reflect the policy set out in the DPCR5 FPs, the NADPR RIGs and the outcome of the September 2015 consultation and the December 2015 consultation. We published our DPCR5 Close out Decision in June 2016 alongside our statutory consultation.

DPCR5 Network Output Measures

2.2. In DPCR5 we created new indicators called Network Output Measures (NOMs). These were designed to distinguish between DNOs that had innovated and found alternative methods to deliver customers' needs more efficiently, against those that had deferred investment at the expense of network health, loading and/or performance. We concluded that DNOs should retain a share of genuine efficiency improvements and should not benefit from not doing work or deferring work that benefits consumers.

2.3. If a company fails to invest in the network it is likely that the network reliability will suffer. However, it may be a long time before network interruptions increase as a result of reduced maintenance expenditure, lower asset replacement or refurbishment expenditure.

2.4. As part of our DPCR5 FPs, we stated that in return for the revenues received from customers over DPCR5, DNOs were required by the end of the price control period (2015) to have delivered a "package of output measures", including:

- **Health Indices (HIs)** - measures of the health of the DNOs' assets. They are based on a combination of age, condition data and fault history. Asset categories range from HI1 assets, which are new or "as new" assets at the beginning of their asset lives, to HI5 assets which are towards the end of their asset lives. HI4 and HI5 assets may require replacement or refurbishment.
- **Load Indices (LIs)** - measures of the loading on primary substations on the DNOs' networks based on peak demand at each substation site and firm capacity. Asset categories range from LI1 with a relatively low level of loading to LI4 and LI5 which represent peak loading above firm capacity and which may require adding additional capacity through network reinforcement.
- **Fault Rates** - measures of asset reliability in terms of the number of faults which occur annually and over a number of years. They only apply to assets which presently have no HIs. For this reason, Fault Rates are referred to as a 'secondary' network output measure.

Key policy components of DPCR5 NOMs Failure to Deliver Outputs Methodology

2.5. Key components of the DPCR5 NOMs Failure to Deliver Outputs Methodology include:

- a Performance Assessment of whether the DNO has delivered an agreed (or equivalent) package of NOMs (comprising of a quantitative and qualitative assessment of the three individual components of the NOMs – HIs, LIs and Fault Rates).
- the introduction of a quantitative materiality threshold of 5% for HIs and LIs and a 10% materiality threshold for Fault Rates;
- a provision to allow either DNOs or Ofgem to make changes to the agreed DPCR5 outputs to account for Material Changes, in particular for HIs and LIs (eg changes in input data, methodologies, external factors and changes in asset management approach). This involves making appropriate adjustments to the Agreed Network Outputs to take account of Material Changes in line with the original intent in DPCR5 FPs and the NADPR RIGs. For LIs, Material Changes will include changes in capacity. Changes in demand will be captured from the Load Related Reopener uncertainty mechanism, in line with DPCR5 FPs. We would make these revisions prior to carrying out the final assessment of whether there is an outputs gap and the value of any outputs gap; and,
- monetising Fault Rates to ensure a consistent approach to performance assessment for all asset classes not covered by HIs, where asset replacement or refurbishment expenditure was allowed in DPCR5. The methodology to monetise Fault Rates ensures a broadly consistent treatment across all NOMs.

Proposed changes to the Handbook

2.6. Part 3, Chapter 16 of the existing Handbook contains the “DPCR5 Network Output Measures - failure to deliver outputs adjustment” methodology. We propose to:

- amend Chapter 16;
- introduce a new Annex A1 to the Handbook setting out the new “DPCR5 NOMs Failure to Deliver Outputs Methodology”; and
- introduce a new Annex A2 to the Handbook setting out “NOMs Risk Points Methodologies”.

Reasons for changes

2.7. The reason for amending Chapter 16 is to reflect and reference the addition of a new "DPCR5 NOMs Failure to Deliver Outputs Methodology". The other reason for amending Chapter 16 is to introduce the potential for a licensee to have to restate information and thus for the Authority to re-run its assessment of that licensee's performance if that licensee has not provided sufficiently robust and consistent data.

2.8. The reason for introducing the new Annex A1 is to set out the methodology the Authority will use to assess whether the licensee has delivered its DPCR5 NOMs outputs, comprising HIs, LIs and Fault Rates and, if not, whether there should be any adjustment to its allowed revenue.

2.9. The reason for introducing the new Annex A2 is to set out the methodologies the Authority will use for calculating the HI Risk Points, LI Risk Points and Fault Rate Points as part of its quantitative assessment of whether each licensee has delivered its DPCR5 NOMs outputs.

Load Related Re-opener

2.10. Load related expenditure is the costs of adding more capacity to the distribution networks to connect more customers and to accommodate increased demand. When we set the DPCR5 we recognised that there was significant uncertainty in economic conditions which could impact on forecast load growth and volume of new connections and the need for investment. We therefore included two uncertainty mechanisms to allow the DNOs to be funded for these costs later in the period.

2.11. In DPCR5 we introduced a volume driver for high volume low cost (HVLC) connections. The volume drivers modify the allowed revenues according to the volume of work done. The volume driver for these connections adjusts to HVLC connections baseline to reflect the actual volume of connections multiplied by the unit cost we specified at DPCR5. It also takes account of the actual proportion of gross HVLC connections expenditure that is recovered through connection charges.

2.12. We also introduced a reopener to recalculate the allowed revenues for specified costs (called the Load Related Re-opener) for general reinforcement (excluding fault level reinforcement) and low volume high cost (LVHC) connections to limit the extent to which DNOs are exposed to volume risk and the extent to which they can earn additional returns through a drop off from forecast load growth. General reinforcement typically consists of lumpy projects at the higher voltages which have significant variability in unit costs. LVHC connections are a subset of demand connections for which there are relatively small volumes and significant variability in unit costs.

Key policy components of the proposed Load Related Re-opener Methodology

2.13. Key components of the Load Related Re-opener Methodology include:

- a materiality threshold for the Load Related Re-opener comprising two parts:
 - the reopener can be triggered if efficient expenditure is at least 20% higher or 20% lower than the baseline; and
 - the additional costs above or reduced costs below the reopener threshold baseline, after application of the efficiency incentive rate, must be greater than 1% of DPCR5 base revenue for an adjustment to be made;
- provisions to avoid double counting between the Load Related Re-opener and LI NOMs;
- provisions to take into account the offsetting impact of any efficiencies that the companies have made through innovative techniques to avoid general reinforcement or LVHC connections expenditure such as demand-side management, smart grid technologies, energy storage or other innovative approaches; and
- discount the impact of real price effects (RPEs) from any adjustments applied under the Load Related Re-opener.

Proposed changes to the Handbook

2.14. Part 3, Chapter 15 of the existing Handbook contains the “DPCR5 Load Related Re-opener - adjustment resulting from revised allowance levels” methodology. We propose to:

- amend Chapter 15; and
- introduce a new Annex B to the Handbook setting out the new “Load Related Re-opener Legacy Assessment Methodology”.

Reasons for changes to the Handbook

2.15. The reason for amending Chapter 15 is to reflect and reference the addition of a new Load Related Re-opener Methodology.

2.16. The reason for introducing a new Annex B is to set out the methodology by which the Authority will use to assess load related expenditure to determine whether

the licensee has triggered the Load Related Re-opener and, if so, the value of any adjustment to its allowed revenue.

High Value Projects

2.17. High Value Projects (HVPs) were defined in DPCR5 as discrete projects with a value of more than £15m over the lifetime of the project (in 2007-08 prices).

2.18. At DPCR5 there were a range of HVPs which we considered separately as part of the cost assessment. We included an assumption for the costs associated with these projects in the FP allowed revenues. We recognised that there was uncertainty as to the need and costs of this work and therefore we also included an expenditure reopener for HVPs. In addition, DNOs committed to delivering specific outputs for each individual HVP.

Key policy components of the HVP methodologies

2.19. Key components of the HVP Re-opener Methodology include:

- a materiality threshold comprising two parts:
 - the reopener can be triggered if efficient expenditure is at least 20% higher or 20% lower than the baseline; and
 - the additional costs above or reduced costs below the reopener threshold baseline, after application of the efficiency incentive rate, must be greater than 1% of DPCR5 base revenue for an adjustment to be made
- removing the possibility of double counting between the HVP Re-opener and HVP outputs adjustment;
- taking into account the fact that projects may be at different stages in their delivery;
- offsetting the impact of any efficiencies that the companies have made through innovative techniques such as demand-side management, smart grid technologies, energy storage or other innovative approaches; and
- discounting the impact of RPEs from any adjustments applied under the HVP Re-opener.

2.20. Key components of the HVP Outputs Review Methodology include:

- taking into account the fact that projects may be at different stages in their delivery;
- reflecting whether or not outputs have been delivered and the type of projects delivered; and
- ensuring that any partial delivery of outputs and/or any changes in outputs is reflected in our assessment of whether there is an outputs gap and the valuation of the outputs gap.

Proposed changes to the Handbook

2.21. Part 3, Chapter 15 and Chapter 16 of the existing Handbook contains the “DPCR5 High Value Projects Re-opener” and “DPCR5 High Value Projects failure to deliver outputs” methodologies. We propose to:

- amend Chapter 15 and Chapter 16;
- introduce a new Annex C1 to the Handbook setting out the new “HVP Re-opener Legacy Assessment Methodology”; and
- introduce a new Annex C2 to the Handbook setting out the new “HVP Network Outputs Review Methodology”.

Reasons for changes to the Handbook

2.22. The reason for amending Chapters 15 and 16 is to reflect and reference the addition of two new HVP methodologies.

2.23. The reason for introducing a new Annex C1 is to set out the methodology by which the Authority will use to assess HVP costs to determine whether the licensee has triggered the HVP Re-opener and, if so, the value of any adjustment to its allowed revenue.

2.24. The reason for introducing a new Annex C2 is to set out the methodology which the Authority will use to assess whether the licensee has delivered its HVP outputs and, if not, whether there should be any adjustment to its allowed revenue.

Traffic Management Act Permit Costs

2.25. Traffic Management Act Permit Costs are the costs of complying with traffic management legislation when a company is undertaking activities which involve the occupation of the highway. For example, it includes the cost of administering notifications of street works, suspensions and closures of the highway such as traffic signals, the cost of inspections undertaken by the highway authority, and congestion charging.

2.26. When we set allowances for traffic management costs at DPCR5, we did not include the costs associated with Permitting Schemes as there was insufficient information on these costs at the time. The introduction of Permitting Schemes is entirely at the discretion of the local authorities. Permitting Schemes provide local authorities with an alternative to the noticing system whereby DNOs inform them of their intentions to carry out work. A Permitting Scheme requires a DNO to apply for a permit to do the works which incur a cost. The local authority can also set conditions when granting the permit.

2.27. The costs associated with Permitting Schemes were instead logged up by companies to be reclaimed at the end of DPCR5. These costs include the cost of the permits, conditions associated with the permits, set up and administration costs. These logged up costs can now be assessed in order to make appropriate adjustments to allowances.

Key policy components of the DPCR5 Traffic Management Act Permit Costs reopener

2.28. Key components of the DPCR5 Traffic Management Act Permit Costs reopener include:

- the Authority carrying out an assessment of costs reported by a licensee using a combination of qualitative and quantitative methods in order to assess cost efficiency for each of four permitting cost components - Permit Costs, Permitting Conditions Costs, System Set Up Costs and Incremental Administration Costs;
- an assessment excluding costs and volumes outside the price control e.g. costs and volumes associated with connection costs not subject to the apportionment rule are excluded; and
- applying a materiality threshold of one percent of the licensee's DPCR5 revenue allowance.

Changes to the Handbook

2.29. Part 3, Chapter 15 of the existing Handbook contains the "DPCR5 Traffic Management Act Permit Costs adjustment" methodology. We propose to:

- amend Chapter 15; and
- introduce a new Annex D to the Handbook setting out the new "Traffic Management Permit Costs Legacy Assessment Methodology".

Reasons for changes to the Handbook

2.30. The reason for amending Chapter 15 is to make minor clarifications to how Ofgem will determine the Traffic Management Act Permit Costs adjustment to allowed revenue for the licensee, including a materiality test to check applicability for the adjustment.

2.31. The reason for introducing Annex D is to set out the methodology for calculating efficient traffic management permitting costs.

Flood prevention costs

2.32. Scottish and Southern Electricity in its Hydro region in the north of Scotland (SSEH) was not given any baseline expenditure allowance for flood prevention works in DPCR5 because information was not available in time for an assessment of expenditure requirements to be carried out. As a result, SSEH was allowed to log-up its expenditure to allow for the subsequent award of expenditure allowance amounts.

Key policy components of the DPCR5 Flood Prevention methodology

2.33. The methodology includes:

- (1) a cap of £2.3 million, in 2007-08 prices (£2.7m in 2012/13 prices), on allowed expenditure relating to the protection of substations against flooding during DPCR5; and
- (2) a test that SSEH's expenditure represents a cost 'per risk reduced' that is above the 'upper quartile £ per risk reduced'.

Changes to the Handbook

2.34. We are introducing a new "DPCR5 Flood Prevention - adjustment resulting from revised allowance levels" methodology in Chapter 15 of the Handbook.

Reasons for changes to the Handbook

2.35. There is no existing methodology on DPCR5 Flood Prevention in the Handbook. The changes will enable SSEH to recover flood prevention costs up to a cap of (£2.7m in 2012/13 prices) where that expenditure is calculated to be above the 'upper quartile £ per risk reduced'.

Performance Assessment Submission

2.36. We will write to the DNOs with regard to their Performance Assessment Submission to inform Ofgem’s DPCR5 Close out assessment. We will request that DNOs provide further information by 31 October 2016.

2.37. The Authority will only request information in the Performance Assessment Submission where it identifies gaps in its existing information or where specific questions have arisen.

2.38. The information requested by the Authority will be proportionate and will include any outstanding information required to address issues identified. The Authority will inform each licensee of the specific information required to be submitted by the licensee in its Performance Assessment Submission in relation to NOMs, HVPs, the Load Related Re-opener and Traffic Management Act Permit Costs.

Proposed changes to the Handbook

2.39. We propose to introduce a new Annex E “Performance Assessment Submission” to provide clarity on the reporting requirements.

Reasons for changes to the Handbook

2.40. There is no existing text outlining the reporting requirements on the DNOs as part of their Performance Assessment Submission. Annex E has been developed to reflect the reporting requirements associated with the other draft methodologies. It has been developed through engagement with the Working Group.

3. Responses to the statutory consultation

Chapter Summary

This chapter summarises the key comments we received to our informal consultation on the RIIO ED1 Financial Handbook drafting with respect to each of the methodologies and highlights where we have changed the licence drafting in response to those comments.

3.1. We received 6 responses to our statutory consultation on changes to the RIIO-ED1 Financial Handbook. All responses were marked as non-confidential and are published on our website.

3.2. We set out below a summary of substantive comments by methodology. We note that there were a significant number of other drafting comments. Alongside this document we have published an Issues Log which sets out all of the comments received to both the informal consultation and the statutory consultation and how we have addressed these.

DPCR5 Network Output Measures

3.3. In this section we have summarised substantive comments relating to the following sections of the Handbook:

- Chapter 16: DPCR5 NOMs revenue adjustment;
- Annex A1: DPCR5 NOMs Failure to Deliver Outputs Methodology; and
- Annex A2: NOMs Risk Points Methodologies.

3.4. All 6 respondents commented on the NOMs drafting. The key responses and our views are summarised in Table 1.

Table 1: DPCR5 NOMs

Summary of comment	Our views/ changes to drafting
<p>Calculating Risk Points for the HI Target Delta</p> <p>One respondent highlighted that the current drafting in Annex A2 did not clearly state what data will be used to generate the HI Risk Point Delta and could lead to confusion.</p>	<p>We agree with this comment. We have changed the methodology to provide clarity on the data that would be used to generate the HI Risk Point Delta.</p>

<p>Fault Rate measure</p> <p>One DNO noted that they did not believe that the application of penalties to fault rate performance provides a direct link to investment activity during DPCR5. However, they considered that the approach Ofgem had proposed which: (1) reviewed actual performance against forecasts; and (2) provided DNOs with the opportunity to provide justification to explain the actual performance, was appropriate.</p>	<p>Fault Rates are defined as an Agreed Network Output and were introduced to deal with assets not covered by the HI mechanism. We therefore retain the view that having financial consequences for the failure to deliver Agreed Network Outputs is appropriate and in line with the original policy intent of DPCR5.</p>
<p>Materiality threshold for Fault Rates</p> <p>One respondent noted that they had proposed a higher materiality threshold for Fault Rates but recognised that the 10% threshold proposed by Ofgem went some way to mitigating the external factors which can influence Fault Rates. They further noted that the opportunity presented by the methodology to explain variations beyond the threshold meant 10% was acceptable.</p>	<p>We welcome the respondent’s comment. We retain the view that a materiality threshold of 10% is prudent to allow for the variations caused by factors such as annual weather fluctuations, third party damage, overloading and bird strikes, defects.</p>

Load Related Re-opener

3.5. In this section we have summarised substantive comments and our views relating to the following sections of the Handbook:

- Chapter 15: DPCR5 Load Related Re-opener - adjustment resulting from revised allowance levels; and
- Annex B: Load Related Re-opener Legacy Assessment Methodology.

3.6. Four respondents commented on these sections. There were no substantive comments on the Load Related Re-opener either in Chapter 15 or Annex B. We set out how we responded to each comment raised in the Issues Log which we have published alongside this document.

High Value Projects

3.7. In this section we have summarised substantive comments and our views relating to the following sections of the Handbook:

- Chapter 15: DPCR5 High Value Projects Adjustments/ Chapter 16: DPCR5 High Value Projects - failure to deliver outputs adjustment;
- Annex C1: HVP Re-opener Legacy Assessment Methodology; and
- Annex C2: HVP Network Outputs Review Methodology.

3.8. Six respondents commented on these sections. There were no substantive comments on HVP. We set out how we responded to each comment raised in the Issues Log which we have published alongside this document.

Traffic Management Act Permit Costs

3.9. In this section we have summarised substantive comments and our views relating to the following sections of the Handbook:

- Chapter 15: DPCR5 Traffic Management Act Permit Costs adjustment; and
- Annex D: Traffic Management Permit Costs Legacy Assessment Methodology.

3.10. Four respondents commented on these sections. There were no substantive comments on Traffic Management Act Permit Costs. We set out how we responded to each comment raised in the Issues Log which we have published alongside this document.

Flood prevention costs

3.11. In this section we have summarised substantive comments relating to the following sections of the Handbook:

- Chapter 15: DPCR5 Flood Prevention - adjustment resulting from revised allowance levels.

3.12. Two respondents commented on this chapter. There were no substantive comments on Flood Prevention either in Chapter 15 or Annex D. We set out how we responded to each comment raised in the Issues Log which we have published alongside this document.

Performance Assessment Submission

3.13. In this section we have summarised substantive comments relating to the following sections of the Handbook:

- Annex E: Performance Assessment Submission.

3.14. Four respondents commented on this annex. There were no substantive comments on Annex E. We set out how we responded to each comment raised in the Issues Log which we have published alongside this document.

Definitions

3.15. Four respondents commented on the definitions set out in Appendix 1. There were no substantive comments on the definitions. We set out how we responded to each comment raised in relation to definitions in the Issues Log which we have published alongside this document.

Other

3.16. A number of respondents commented on changes to other sections of the Handbook. The key responses and our views are summarised in Table 2.

Table 2: Other/overarching comments

Summary of comment	Our views/ changes to drafting
<p>Process for formally stopping the assessment process</p> <p>Two DNOs outlined the view that the DNOs require assurances that, if any new information is identified as a result of the spring 2017 consultation process that causes the Authority to propose a revenue adjustment that was not signalled in July 2016, the relevant DNO will have the opportunity to provide any relevant evidence it may have available before any Authority decision is made on the revenue adjustment.</p>	<p>We retain the view that, where our initial assessment suggests that no adjustment is needed because the licensee has delivered its outputs, we still need consult on our proposal just as we would where we do propose to make an adjustment. This is to ensure a fair and transparent process and allow stakeholders to feed into the process ahead of our final decision.</p> <p>However, we recognise the concerns raised by the DNO regarding any new issues being raised. We agree that the DNO should have the opportunity to provide any relevant evidence before the Authority makes its final decision on any revenue adjustment.</p>

	<p>To address this we have added additional text to Chapters 15 and 16 to clarify that the licensee will have the opportunity to submit any additional information that it considers should be taken into account by the Authority.</p>
<p>Real Price Effects (RPEs)</p> <p>One respondent supported Ofgem’s proposed approach to RPEs on the basis that it clearly allocated the risk of variation to the DNOs. However, it noted that the impact of this variation needed to be adjusted for in assessing the two reopeners.</p>	<p>We agree. We consider that the methodologies correctly reflect this.</p>
<p>Previously raised comments</p> <p>One respondent noted that it had not repeated previous points or arguments it had made with respect to the substantive proposals but noted that those points remain valid.</p>	<p>We note that a number of substantive comments have previously been raised on the proposals. In our Decision document on the DPCR5 Close out methodologies, published alongside our Statutory Consultation, we set out our response to the substantive points raised including our reasoning.</p>

4. Next steps

Chapter Summary

This chapter sets out the next steps in the process for DPCR5 Close out.

4.1. The timetable for making the necessary changes to the Handbook to incorporate the DPCR5 Close out methodologies is set out in Table 3.

Table 3: Timetable for DPCR5 Close out methodology development

Stage	Date
Licence modification decisions and modifications published	29 July 2016
Licence changes come into effect	24 Sept 2016
Licensees to provide Performance Assessment Submissions	31 Oct 2016
Authority to provide a Preliminary View to each licensee on any adjustments to the licensee's revenue under the relevant methodology	28 Feb 2017
Formal two month consultation on any adjustments to the licensee's revenue	31 May 2017
Authority's Notice of its decision	30 Sept 2017

4.2. In line with the deadline set out in the Handbook, we are publishing our Handbook modification decisions before 31 July 2016. The changes will come into effect 56 days following the publication.

4.3. In the next stage of the process we will undertake an assessment of each licensee's performance to determine whether we will be making any adjustments to the revenues of the DNOs. The DNOs will be required to submit their Performance Assessment Submissions by 31 October 2016. We will then commence our assessment of each licensee's performance, in order to close out all of these mechanisms by making any revenue adjustment for the November 2017 AIP.

Appendices

Appendix	Name of Appendix	Page Number
1	Consultation response and questions	22
2	Financial Handbook structure and proposed modifications	23
3	Feedback questionnaire	25

Appendix 1 – Summary of responses

1.1. We received 6 responses to our Statutory Consultation. None of the responses was marked as confidential.

1.2. All responses are summarised in an Issues Log which is published alongside this document.

Appendix 2 – Financial Handbook structure and proposed modifications

Section	Part 3 of the RIIO-ED1 Financial Handbook	Proposed change for DPCR5 Close out	Associated Document Created?
Chapter 15: Legacy price control adjustments – financial methodologies			
1	Overview	Amendments	No
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	Amendments	No
2i	DPCR5 Pension adjustment	No Change	No
2ii	DPCR5 Tax adjustment	No Change	No
2iii	DPCR5 Distributed Generation adjustment	No Change	No
2iv	DPCR5 DUoS Bad Debts adjustment	No Change	No
2v	DPCR5 Traffic Management Act Permit Costs adjustment	Amendments	No
2vi	DPCR5 Undergrounding and Worst Served Customer Improvements adjustment	Amendments	No
2vii	DPCR5 Load Related Re-opener - adjustment resulting from revised allowance levels	Amendments	No
2viii	DPCR5 High Volume Connections Volume Driver - adjustment resulting from revised allowance levels	No Change	No
2ix	DPCR5 High Value Projects Re-opener - adjustment resulting from revised allowance levels	Amendments	No
2x	DPCR5 Enhanced Physical Site Security and Black Start -adjustment resulting from revised allowance levels	No Change	No
2xi	DPCR5 Shetland adjustment	No Change	No
2xii	DPCR5 Flood Prevention - adjustment resulting from revised allowance levels	New	No
2xiii	Determination of the OLREV value for the licensee	Amendments	No

3	Determination of revisions to the PCFM Variable Values for legacy adjustments to DPCR5 RAV Additions (OLRAV values)	No Change	No
4	Section 4 – Direction of revisions to the OLREV value and to OLRAV values	Amendments	No
Chapter 16: Legacy DPCR5 RAV Rolling Incentive adjustments - financial methodologies			
1	Overview	Amendments	No
2	Determination of revisions to the PCFM Variable Value for legacy adjustments associated with the DPCR5 RAV Rolling Incentive mechanism (the RIREV value)	Amendments	No
2i	Adjustment for items subject to DPCR5 IQI Incentive Rates	No Change	No
2ii	DPCR5 High Value Projects - failure to deliver outputs adjustment	Amendments	No
2iii	DPCR5 Network Output Measures - failure to deliver outputs adjustment	Amendments	No
2iv	DPCR5 Rising and Lateral Mains - adjustment relating to the level of customer contributions	No Change	No
2v	DPCR5 Workforce Renewal - adjustment resulting from overspend or underspend against allowance	No Change	No
3	Section 3 – Determination of revisions to the PCFM Variable Value for legacy adjustments associated with the DPCR5 RAV Rolling Incentive mechanism (the RIREV value)	No Change	No
4	Direction of revisions to the RIREV value	No Change	No
Appendix 1	Glossary	Amendments	No
Annexes			
A1	DPCR5 NOMs Failure to Deliver Outputs Methodology	New	No
A2	NOMs Risk Points Methodologies	New	No
B	Load Related Re-opener Legacy Assessment Methodology	New	No
C1	HVP Re-opener Legacy Assessment Methodology	New	No
C2	HVP Network Outputs Review Methodology	New	No
D	Traffic Management Permit Costs Legacy Assessment Methodology	New	No
E	Performance Assessment Submission	New	No

Appendix 3 – Feedback questionnaire

1.1. Consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. We would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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