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Consultation

Consultation on the closeout methodologies for RIIO-ED1

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We are consulting on the closeout methodologies for RIIO-ED1. This document outlines the scope and purpose of the consultation, asks the questions on which we are consulting and explains how you can get involved. Once the consultation is closed, we will consider all responses. We want the consultation process to be transparent. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at **Ofgem.gov.uk/consultations**. If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential and, if possible, put the confidential material in separate appendices to your response.

Contents

Executive summary

We are proposing methodologies to closeout six elements of the RIIO-ED1 Price Control, which runs until 31 March 2023. These are:

- Load Related Expenditure;
- Net contributions from customers towards gross reinforcement costs, known as Net to Gross;
- Network Output Measures/Network Asset Secondary Deliverables;
- High Value Projects (HVP);
- Expenditure associated with Link Box Replacement Volumes; and
- Expenditure associated with Shetland Extension Fixed Energy Costs, Shetland Extension Battery Costs, and Shetland Enduring Solution Process Costs.

We have based the methodologies on the approach and principles we described in the RIIO-ED1 Strategy Decision.[1]

In relation to five of the elements consulted upon, further development of the detail in line with those principles was required. We have highlighted any significant proposed changes from what we originally set out together with the rationale for such proposals.

The final element, relating to Shetland Extension costs, was introduced after the start of the price control. This relates only to Scottish and Southern Energy Power Distribution: Scottish Hydro Electric Power Distribution (SSEH). As with the other areas, further details were required to set out arrangements to address variations from cost forecasts, which have been addressed with a methodology.

We have worked with the Distribution Network Operators (DNOs) to develop the proposed methodologies and, subject to consultation, a final version will be included in the RIIO-ED2 Price Control Financial Handbook.

We welcome views from stakeholders on our suggested approach outlined in Chapters 2 to 6, and on the detailed draft methodologies set out in the appendices.

[1] Final Proposals for the RIIO-ED1 electricity distribution price control: https://www.ofgem.gov.uk/sites/default/files/docs/2013/02/riioed1decuncertaintymechanisms_0.pdf

1. Background and overview

Background

1.1. The RIIO-ED1 price control sets the outputs that the electricity distribution network operators (DNOs) must deliver, and the revenues they are allowed to collect from customers, between 1 April 2015 and 31 March 2023. An objective of the RIIO (Revenue = Incentives + Innovation + Outputs) framework is to drive real benefits for customers by incentivising network companies to deliver a low cost, sustainable programme of work that will meet low carbon demands.

1.2. Within RIIO-ED1 there are a number of cost areas that require specific mechanisms to account for their uncertain nature. As a result of these mechanisms, some areas of the price control need to be settled ("closed out") once the price control has ended. These mechanisms include reopeners which deal with over or underspend, and output mechanisms which enable us to penalise DNOs if they have not delivered the outputs they were funded to deliver.

1.3. Table 1 provides a brief description of the six areas of the price control that require a methodology for closeout; we are consulting on the proposed methodologies that will form part of the RIIO-ED2 Financial Handbook. Following a decision on these methodologies, we will consult on any required modifications to the licence.

Table 1: Cost areas for closeout

Area	Description	Window(s) and direction
Load-related Expenditure Reopener	This applies to costs associated with accommodating new and changing patterns of customers' electricity use (load related expenditure) above or below what was included in the price control settlement.	2017 and 2020 – DNOs can trigger the mechanism upwards (i.e. to increase allowances) or downwards (i.e. to decrease allowances) 2023 – Ofgem can trigger upwards or downwards (i.e. to increase or reduce allowances)
Net to Gross*	This applies to the difference between the forecast percentage of customer contributions to reinforcement work, and the actual amount that is contributed. The price control settlement defined an expected range of Net to Gross ratios, outside of which DNOs are expected to provide an explanation for the circumstances that have led to this deviation.	2023 – Ofgem review the evidence provided by the DNOs (if applicable) and determine whether this justifies the final position; if it does, no adjustment to revenues will be made.
Network Asset Secondary Deliverables (NASDs) or Network Output Measures (NOMs)	NOMs are a key indicator of asset health used during RIIO-ED1, as measured by the Health Indices (HIs). DNOs have committed to delivering specific outputs relating to NOMs; we can adjust DNOs' revenue downwards where they have failed to deliver outputs, or upwards for justified over delivery of outputs.	2023 – Ofgem review of output delivery assessment.

High Value Projects (HVPs)	This applies to high-value schemes that were specified and agreed with individual DNOs to be undertaken in RIIO-ED1.	2019 – DNOs can trigger the mechanism to seek funding for new HVPs only 2023 – Ofgem review of efficient expenditure, plus consideration of output delivery (interaction with NOMs) where the driver for the HVP is either asset replacement or refurbishment. Ofgem can trigger the mechanism upwards or downwards, including in respect of existing HVPs.
Link Boxes	This applies to the costs associated with mitigating the risk of disruptive failure of link boxes for UKPN and SPMW only.	2017 – DNOs can trigger the mechanism to seek additional funding 2023 – Ofgem review of efficient expenditure
Shetland	This relates to the costs associated with managing an extension of services to meet electricity demand on Shetland, up to 2023.	2017 – SSEH can trigger the mechanism to seek additional funding 2023 – Ofgem review of efficient expenditure

*This only applies where no adjustment is being made under the Load Related Expenditure Reopener

DPCR5 Closeout

1.4. The last electricity distribution price control (DPCR5) established an initial approach to closeout, setting out that network company allowances would be adjusted based on performance in a number of areas.[2]

1.5. While the process took place after the end of the price control, it laid the foundations for one approach to closeout. Having considered the relevant documentation in producing clear methodologies for assessing company performance, the process adjusted DNOs' allowances by more than £200m (in 2012/13 prices).

Approach

1.6. Our starting point for each methodology has been to review what was set out in the following documents: the RIIO-ED1 Strategy Decision,[3] Final Determinations,[4]

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[2] https://www.ofgem.gov.uk/publications-and-updates/dpcr5-closeout-decision-adjustments-allowances
[3] https://www.ofgem.gov.uk/publications-and-updates/strategy-decision-riio-ed1-overview
[4] https://www.ofgem.gov.uk/publications-and-updates/riio-ed1-final-determinations-slow-track-electricity-distribution-companies

Licence,[5] Regulatory Instructions and Guidance (RIGs),[6] and the Financial handbook,[7] We used these documents as a basis for building on the DPCR5 Closeout approach where appropriate.

1.7. Where possible, we have looked to establish a principles-based approach for the methodologies, maintaining consistency across the different areas as far as possible. This approach emerged from the review of the documents mentioned in sub-paragraph 1.6.

1.8. The RIIO-ED1 RIGs built upon reporting in DPCR5 and the business plan data templates used to collect data for RIIO-ED1 investment proposals, and were developed in conjunction with the DNOs after publication of our Final Determinations; they have continued to evolve over time. Further details are provided in the relevant chapters.

Asset management and network planning

1.9. To ensure Network Output Measures (NOMs) performance metrics are reported correctly, we have been developing our understanding of asset management and network planning practices of licensees. This includes the on-site verification of input data to the Common Network Asset Indices Methodology (CNAIM) model, reviews of Long Term Development Statements (LTDS) and other incentives linked to aggregated data sources. This programme could lead to additional works that may involve independent reviews of processes and data. Should any deficiencies in either asset, system or incentive performance data be found, we will consider appropriate action which may include relevant and proportionate recovery of ED1 funding.

Next Steps

1.10. We will review all responses to the consultation and update the proposed methodologies, where appropriate. We expect to publish the finalised methodologies around May 2019, and will follow this with a consultation on any required modifications to the licence.

Your response, data and confidentiality

1.11. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.12. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate

[5] https://www.ofgem.gov.uk/publications-and-updates/riio-ed1-modifications-special-conditions-electricity-distribution-licences-held-slow-track-licensees
[6] https://www.ofgem.gov.uk/publications-and-updates/direction-make-modifications-regulatory-instructions-and-guidance-rigs-riio-ed1-version-40
[7] https://www.ofgem.gov.uk/publications-and-updates/latest-price-control-financial-handbooks-riio-network-operator-licensees

appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.13. If the information you give in your response contains personal data under the General Data Protection Regulation 2016/379 (GDPR) and domestic legislation on data protection, the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

1.14. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

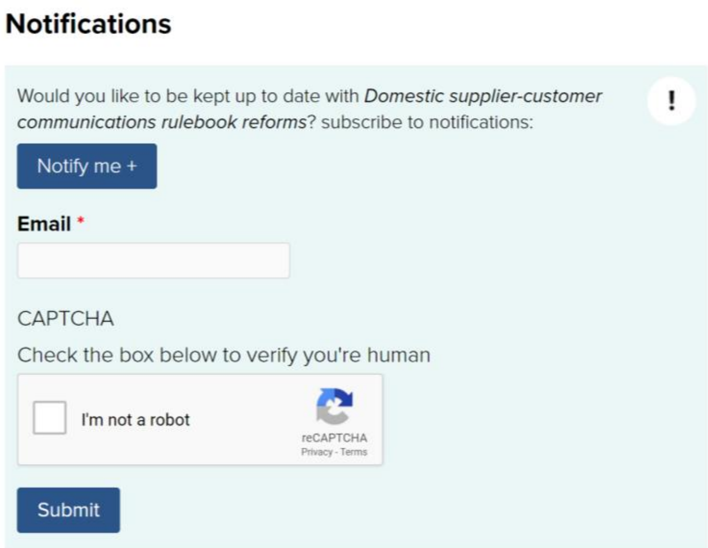
1.15. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall consultation process?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website. Ofgem.gov.uk/consultations.



2. Load Related Expenditure

Section summary

To manage the uncertainty surrounding the impact of demand and generation on the networks, the Load Related Reopener accounts for material over- or underspends against allowances, where efficient. This mechanism builds on the approach taken in DPCR5.

Background to Load

2.1. Load-related expenditure (LRE) covers the costs of developing the networks to accommodate increased demand and generation, as well as managing the changing patterns of customers' use of the networks. With the advent of renewable energy and low carbon technologies ((LCTs), including heat pumps, electric vehicles (EVs) and distribution connected generation (DG)) remaining uncertain when we set RIIO-ED1, we recognised the impact this could have on forecasts of load growth and the volume of new connections.

2.2. The uncertainty around the investment that may be needed warranted the inclusion of an uncertainty mechanism, to protect both customers and DNOs from changes to investment requirements. We therefore included a reopener (the load-related reopener, LRR) that allows for an adjustment to allowed revenues for LRE.

Load assessment

2.3. The RIIO-ED1 Strategy Decision[8] noted that the uncertainty around LRE in RIIO-ED1 had increased since DPCR5, partly due to the lack of clarity around how the uptake of LCTs would impact the network. We therefore included a reopener that built on the principle defined in DPCR5, expanding the scope of expenditure within it.

2.4. The reopener allows for DNOs to submit a request for additional allowances where they can demonstrate that their additional costs exceed the relevant materiality threshold, and are efficient. These costs cover a number of categories, broadly:

- Primary and Secondary Network General Reinforcement;
- Primary and Secondary Network new and modified connections; and
- Fault Level Reinforcement.

2.5. The reopener allows for the recovery of efficient costs outside a deadband, provided that the costs are material. DNOs remain exposed to a proportion of any overspend incurred before the materiality threshold is reached. DNOs can trigger the reopener during two windows (as detailed in Table 1 of Chapter 1) if they can

[8] https://www.ofgem.gov.uk/sites/default/files/docs/2013/02/riioed1decuncertaintymechanisms_0.pdf

demonstrate that their efficient expenditure over RIIO-ED1 is, or will be, different to allowances by an amount greater than a deadband plus the materiality threshold.

2.6. The reopener is symmetrical, and can also be triggered by Ofgem at the end of the price control, if efficient expenditure is materially different from allowances. Where the test (based on the deadband plus the materiality threshold) is not passed, any differences between actual expenditure and allowances will be subject to the Totex Incentive Mechanism (TIM). In all cases, variations in expenditure up to the deadband remain subject to the TIM, whether or not the reopener is triggered.

2.7. The methodology for assessing a DNO's submission during the two within-period windows is already established in Chapter 9 of the RIIO-ED1 Financial Handbook; we are consulting on the methodology the Authority proposes to use if allowances are adjusted at the end of the price control.

2.8. The Load Related Reopener was developed and used as part of the previous price control (DPCR5). The approach taken at DPCR5 can be broadly summarised as:

- Ofgem assessed DNOs' efficient LRE and determined the difference between allowed expenditure and actual expenditure.
- Efficient expenditure was compared against the relevant thresholds; if these tests were met, the reopener was triggered, and Ofgem calculated and applied a revenue adjustment based on efficient expenditure, including those delivered through innovative solutions.
- Ofgem ensured DNOs were not penalised twice (under the LRR and the NOMs LI assessment) by offsetting any double counting.

2.9. The assessment of costs under the LRR followed a number of principles[9] that were developed in accordance with the DPCR5 Final Proposals, the RIGs, and the outcome from working groups on the approach to LRE during DPCR5.

Proposed approach

2.10. As mentioned in paragraph 2.8, the Load Related Reopener (LRR) was developed and used in closing out DPCR5. We have used the DPCR5 approach as a basis, building on it where necessary and simplifying the approach to follow a set of overarching principles. The proposed methodology has been developed in alignment with the requirements of the associated licence conditions, and the approach indicated in the ED1 Strategy Decision and Final Determinations.

2.11. The detailed methodology is set out in Appendix 1. We have included a high-level summary of the proposed approach below:

- Ofgem will evaluate a DNO's efficient level of LRE for RIIO-ED1, which will then be compared against the DNO's allowances for the same period. If Ofgem determine that any difference between these two values meets the criteria set

[9] These principles can be found in Chapter 3 of our Decision on closeout methodologies for the DPCR5 Price Control: https://www.ofgem.gov.uk/publications-and-updates/decision-close-out-methodologies-dpcr5-price-control

out in licence condition CRC 3G (namely that the difference between actual expenditure and allowances is greater or less than 20% of the original allowances, and that the adjustment proposed by Ofgem constitutes a 'material amount'), then it will calculate the value of any adjustment that needs to be made.

  - Ofgem's assessment of the efficient level of LRE will cover the total amount spent over the whole price control, on a net basis (having offset customer contributions to reinforcement schemes), and net of any expenditure avoided as a result of demand-side response or other non-traditional solutions.

  - Unlike at DPCR5, there will be no adjustment on account of real price effects as, in our RIIO-ED1 licence modifications, we chose not to allow for this. The way we set allowances at ED1 (by including RPEs within DNOs' baseline allowances) means there is likely to be less justification for this adjustment at ED1, when compared to DPCR5 (where RPE assumptions were added to baseline allowances).

- This adjustment will then be spread across each year of RIIO-ED1, mirroring the timing of LRE allowances, and have Time Value of Money adjustments applied to it to reflect deferral to 2023/24.

- This aggregate value will then be divided into two portions: one portion to adjust the DNO's Regulatory Asset Value (RAV), and one portion to adjust the DNO's revenue in RIIO-ED2.[10] Any adjustments to the DNO's RIIO-ED2 revenue on account of 'catch up' for RIIO-ED1 revenues will be spread equally across the five years of RIIO-ED2.

2.12. Ofgem's assessment of any applications will include a consideration of the impact of changes in levels or clustering of demand on network assets, and the cost of delivering reinforcement schemes or alternative solutions. Ofgem will also consider offsetting demand-side response ((DSR), and other non-traditional solutions) activities that have avoided reinforcement expenditure, to ensure DNOs are not discouraged from carrying out these activities.

Question 1: What are your views on our proposed approach to assessing the impact of demand changes, and the cost of reinforcement or alternative solutions?

Question 2: Do you agree with our proposal to build on the approach taken at DPCR5 Closeout for load? Do you agree with our proposed approach?

Net to Gross

2.13. If, at the end of the price control, the proportion of Load Related Expenditure (LRE) funded by connections customers is greater (or lower) than a defined percentage, Ofgem may assess whether a DNO has justified this final position. If adequate

[10] The principle is to ensure that the adjustments benefit the same generation of consumers, as far as possible, when compared to a scenario where they had been made in the relevant years.

justification is not given, Ofgem may revise a DNO's total level of LRE, as set out in licence condition 5G.

2.14. This approach will only take place where no adjustment is made under the LRR since any adjustment there will account for any differences (if applicable) in a DNO's overall Net to Gross position. This decision was set out in the relevant licence conditions.

Load Indices (LIs)

2.15. At higher voltages, networks are designed such that customers are not interrupted if a single asset fails. If network loading exceeds this designed capacity, customers may be interrupted if the network fails. To measure risk in this area, we introduced secondary deliverables for reliability – indicators of network performance and whether DNOs are managing their networks effectively. This helps ensure DNOs make efficient investment decisions.

2.16. It is possible to operate substations with high loadings for a limited time without causing immediate network issues, but if loading remains high over longer periods customers are exposed to increased risk of an interruption if equipment fails. The Load Indices (LIs) measures the utilisation of the primary network substations, to track trends in utilisation and to help determine when intervention may be needed to ensure the long-term reliability of the network.

2.17. LIs tie a DNO's investment programme to the delivery of a particular level of utilisation at the end of the price control; the DNOs forecasted a level of utilisation that would be delivered by the schemes included in their baseline allowances.

2.18. DNOs report the LI for each primary substation annually, setting out how the maximum demand at each compares with its firm capacity. This generates the LI and, depending on the level of utilisation, determines a weighting factor to be applied to the number of customers served by that substation to calculate the LI risk points. We can monitor how the overall LI risk points for each DNO's network changes over time, as a result of changing utilisation of substations and reinforcement activities carried out by the DNO.

2.19. We did not set LI targets in the RIIO-ED1 determinations as further work was needed to see how they interact with our view of efficient costs, smart grid savings, and the LRR. We also noted that LIs would not be a formal part of the price control, but would be developed ready for RIIO-2; in our Mid Period Review (MPR) decision, we noted that the use of LI for RIIO-ED1 would be reviewed as part of the closeout of the price control.

Proposed treatment of LIs

2.20. As mentioned above, LIs provide a useful way of measuring and tracking how the DNOs' substations are utilised over time, and help to determine when they should invest to ensure the long-term reliability of the networks. We chose not to set LI targets at the start of the price control, due to the uncertainty around how they would interact with other parts of the price control, instead outlining that they would undergo further work.

2.21. At this stage, we believe that a number of factors continue to contribute to LIs, including the uncertainty around future load growth. Ofgem's assessment of a DNO's expenditure through the LRR includes an assessment of efficiency, and requires DNOs to justify the efficiency of their actual expenditure. This assessment of efficient expenditure would, in our view, include justification for any over-delivery against their LI position as forecast ahead of RIIO-ED1, particularly if inefficient investment decisions were taken.

2.22. We believe that setting targets for LIs would not provide a robust way to measure DNOs' performance in RIIO-ED1, not least because of the uncertainty around future LCT uptake, and the actions that would be the most efficient way to deal with localised growth in loading. We therefore propose that LIs are used as part of the assessment of efficient LRE (i.e. whether investments were necessary), rather than as a standalone close-out mechanism in their own right. We anticipate that further work on LIs will be undertaken as part of RIIO-ED2.

Question 3: Do you agree with our approach to load indices (LIs)? Is there an alternative you believe we should use?

3. Network Asset Secondary Deliverables (NASD)

Section summary

To ensure DNOs develop programmes of work to replace and refurbish their assets, the NASD give indications of the effectiveness of these programmes. They are leading indicators of network performance. The NASD mechanism accounts for over- or under-delivery against targets, where justified. This mechanism builds on the approach taken in DPCR5.

Background to NASD

3.1. As assets age and are subject to environmental conditions, the probability that they will fail increases. DNOs develop programmes of work to replace and refurbish assets to reduce the risk of assets failing and causing interruptions (or other detrimental effects). To measure the reduction in risk delivered by these work programmes, we introduced the Network Asset Secondary Deliverables (NASD), which give indications of the effectiveness of DNOs' investment in their networks. They are leading indicators of network performance, and link closely with network expenditure

3.2. Health and criticality indices, and the associated calculation of monetised risk, are used to assess changes in the risk of DNOs' networks over time. The Health Index (HI) is a composite measure of the age, condition, duty, and failure probability of an asset. The criticality index measures the (financial) consequence of an asset failing and, combined with the health score, calculates a value of risk on each DNO's network.[11]

3.3. DNOs provided forecasts of their asset health and criticality positions for the end of the price control, both with and without investment. These forecasts were used to set targets for improvement for the end of the price control, against which we would measure progress on an aggregate basis (rather than an asset-by-asset or asset-category basis). This gives DNOs flexibility to manage assets and reprioritise activities in the most appropriate way to deal with known and emerging issues on their network.

NASD Assessment

3.4. The RIIO-ED1 Strategy Decision said that the DNOs would be required to demonstrate that they have delivered the network risk reduction that was agreed at the start of the price control. It also reiterated that the justification, and subsequent assessment, of delivery would apply at a total level rather than disaggregated across asset categories or specific assets.

3.5. Licence condition CRC 5D builds on the Strategy Decision's approach, stipulating that DNOs must provide a report to Ofgem detailing their performance against their NASD and justify any deviations (either above or below) from the deadband target level. DNOs also need to provide any supporting analysis or information, within specified timescales, that will enable Ofgem to carry out the assessment. CRC 5D sets out that Ofgem can make an adjustment to RIIO-ED2 allowances and apply a penalty or reward

[11] This value of risk covers asset replacement, refurbishment, and relevant High Value Projects.

rate where a DNO has not justified any under-delivery or has justified over delivery, respectively.

3.6. An assessment of DNOs' delivery of secondary deliverables occurred as part of the closeout of DPCR5. The approach taken comprised the following stages:

- DNOs submitted a 'performance assessment submission' where they set out if they believed they had met their Network Output Measures targets, plus information relating to and justification of their performance.

- Ofgem assessed whether a DNO had met their deliverables and/or whether there was a material gap between targets and delivery. If there was a gap, Ofgem determined the value and adjusted revenues accordingly.

3.7. As with other parts of DPCR5 closeout, Ofgem's assessment followed a number of principles similar to those for LRR and High Value Projects, developed in accordance with the relevant price control documentation, the RIGs, and outputs from ongoing work.

Proposed approach

3.8. The Network Output Measures mechanism was developed for use in closing out DPCR5, and we have built on this approach for NASD in RIIO-ED1. We have looked to simplify the overall approach to follow a set of overarching principles, in line with the other areas of ED1 closeout, as well as the requirements of the licence and the approach indicated in the ED1 Strategy Decision and Final Determinations.

3.9. The detailed proposed methodology is set out in Appendix 1; a high-level summary of the approach is provided below:

- DNOs will submit the relevant changes in the risk factors impacting on their performance against NASD targets, along with a Performance Report. Ofgem will assess these, as well as delivery against the NASD targets. If necessary, DNOs will need to provide further justification for their position.

- Ofgem will assess the evidence provided and determine the value of any adjustment that should be made. This adjustment will be spread across each year of RIIO-ED1 (mirroring the timing profile of associated allowances) and have Time Value of Money adjustments applied to reflect deferral to 2023/24.

- This value will then be divided into two portions – one to adjust the DNO's RAV, and one to adjust the DNO's ED2 revenue. Any adjustments to the DNO's RIIO-ED2 revenue on account of 'catch up' for RIIO-ED1 revenues will be spread equally across the five years of RIIO-ED2.

Question 4: Do you agree with our proposal to build on the approach taken at DPCR5 Closeout for NASD?

Question 5: Do you agree with the manner in which we have developed the DPCR5 approach? Is there an alternative approach you believe we should use?

4. High Value Projects

Section summary

To help mitigate the risk associated with HVPs, we have the ability to review DNOs' expenditure at the end of the price control. As with other areas, differences between a DNO's allowance and their expenditure should be well justified. This mechanism builds on the approach taken in DPCR5.

Background to High Value Products

4.1. High Value Projects (HVPs) for RIIO-ED1 were defined as discrete projects with a value of more than £25m (in 2012-13 prices) in the ED1 Period. There are seven HVPs in RIIO-ED1, four of which received reduced funding following Ofgem's analysis and technical assessment.

4.2. HVPs are discrete projects with specific deliverables, but their size and nature could involve a degree of uncertainty. We therefore included provisions for Ofgem to review DNOs' HVP expenditure, as well as a reopener window for DNOs to propose new HVPs within the price control.

HVP Assessment

4.3. The RIIO-ED1 Strategy Decision stated that the DNOs' reopener would cover both new projects that were not known about when the price control was set, and those projects that were known but were not included in the baseline allowances.[12] It also noted that, if a DNO triggers the reopener within the price control, schemes will be reviewed on a project-by-project basis, through an assessment of whether total HVP expenditure meets a set of thresholds,[13] and that no adjustments would be made on account of existing projects. The Authority's review after the end of the price control period also includes the same requirements for an assessment of expenditure against thresholds; however, unlike the within-period reopener, the Authority has the ability to make adjustments in respect of existing HVPs.

4.4. The reopeners allow DNOs to recover efficient costs above a deadband where the amount outside this deadband is a material amount, but they remain exposed to a proportion of any overspend that is incurred up to the materiality threshold. Similarly, DNOs will retain a proportion of any underspend up to the materiality threshold, and only the unused allowances beyond the threshold will be recovered. Where the materiality test is not passed, any differences between actual expenditure and allowances will be subject to the TIM.

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[12] These projects were not included in the baseline allowances because they failed to have one or more of: clear outputs, forecast costs and/or a needs case.
[13] The threshold tests are set out in Appendix 1 of CRC 3F, and apply to both the within-period reopener and the end of period reopener.

4.5. The ED1 Final Determinations[14] note that there are secondary deliverables associated with HVPs, which cover a variety of different types of work; this leads to a natural interaction with the NASDs. Any assessment of the performance against secondary deliverables for HVPs will only occur where the primary driver is either asset replacement or refurbishment. This assessment, and any corresponding adjustments to allowances, will need to ensure there is no double-counting of over or under delivery through the NASD and HVP assessments.

4.6. As in other areas of the price control, HVPs were assessed as part of the closeout of DPCR5. The approach taken then can be broadly summarised as:

- Ofgem assessed DNOs' efficient HVP expenditure (and output delivery in certain cases) to determine the difference between allowed expenditure and actual expenditure. This accounted for any inefficiencies and efficiencies, including through the use of innovation.

- Efficient expenditure was compared against the relevant thresholds; if these tests were met, the reopener was triggered and Ofgem assessed the value of any outputs gap, ensuring DNOs were not penalised twice (under this mechanism and the outputs mechanism) by offsetting any double counting.

4.7. The assessment of efficient costs under HVPs followed a number of principles, similar to those for LRR, that were developed in accordance with the DPCR5 Final Proposals, the RIGs, and the outputs from ongoing work on how to approach HVPs during DPCR5.

Proposed approach

4.8. As highlighted, the HVP assessment mechanism was developed and used in closing out DPCR5. For RIIO-ED1, we propose to use this approach as a basis, building on it where necessary and simplifying the approach to follow a set of overarching principles. The proposed methodology has been developed in line with the requirements of the licence, and the approach indicated in the ED1 Strategy Decision and Final Determinations.

4.9. The detailed methodology is set out in Appendix 1; a high-level summary of the proposed approach is provided below.

- Ofgem will evaluate a DNO's efficient level of HVP expenditure for RIIO-ED1, which will then be compared against the DNO's allowances for the same period. If Ofgem determines that the difference between these two values meets the criteria set out in the licence (namely that any over or underspend is more than 20% different from allowances, and that the amount beyond this 20% deadband is a 'material' amount), then it will calculate the value of any adjustment that needs to be made.

- Where Ofgem finds that a failure to deliver against required outputs for non-load HVPs has occurred (as indicated by a failure in relation to network asset secondary deliverables associated with a HVP), the related value will be netted off

[14] https://www.ofgem.gov.uk/sites/default/files/docs/2014/11/riio-ed1_final_determination_overview_-_updated_front_cover_0.pdf

the adjustment that would be made where costs are materially different from allowances.

- This adjustment will be spread across each year of RIIO-ED1 (mirroring the timing profile of HVP allowances) and have Time Value of Money adjustments applied (to reflect deferral to 2023/24).

- This resulting value will then be divided into two portions: one to adjust the DNO's RAV, and one to adjust the DNO's revenue in RIIO-ED2. Any revenue adjustments to the DNO's RIIO-ED2 revenue on account of 'catch up' for ED1 revenues will be spread equally across the five years of ED2.

4.10. As noted, Ofgem's assessment of the efficient level of HVP expenditure will cover the total amount spent over the life of the project(s), and may include any adjustments to expenditure to reflect delayed or deferred projects.

Question 6: Do you agree with our proposed approach to HVPs?

Question 7: Do you agree with our treatment of the interaction between HVPs and NASD for assessing an outputs gap for non-load related HVPs?

5. Link Boxes

Section summary

The uncertainty associated with providing funding for the DNOs to mitigate the risk of disruptive link box failures meant we needed to ensure volume delivery is reviewed at the end of the price control. We clearly stated that this would happen as part of the closeout process, and have developed this mechanism to reflect these activities.

Background to Link Boxes

5.1. We introduced an uncertainty mechanism for link boxes specifically to address the costs of mitigating the risk of disruptive failures of link boxes. This became a high-profile issue following a small number of incidents on some DNOs' networks.[15]

5.2. We recognised that this was an important safety issue, but there was a lack of evidence available to set a credible funding plan for RIIO-ED1. Instead, we decided to provide an allowance for UKPN for the first two years of the price control, and to work with the DNOs and the Health and Safety Executive (HSE) to monitor progress in effectively managing risk so as to deal with this issue.

5.3. Following our review of two DNOs' work in this area,[16] we noted that we expected DNOs to deliver the volumes of work they proposed in their submissions and business plans. To assess whether these expectations were met, we clearly highlighted that we intended to review volume delivery as part of the RIIO-ED1 closeout process.

Link box reopener

5.4. One of the reopeners included in RIIO-ED1 was to cover DNOs' costs in effectively managing the risk associated with link boxes. We provided a reopener window in 2017 for either DNOs or Ofgem to propose adjustments to allowances for link boxes. In our decision following that window,[17] we noted our intention to review the delivery of DNO proposed volumes as part of the RIIO-ED1 closeout process.

5.5. As with other mechanisms that are subject to closeout, any adjustment to allowances based on link box volume delivery at the end of the price control will only take place where the size of the adjustment is 'material'.[18] Where it is not 'material', the costs associated with link boxes will be subject to the TIM.

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[15] This was predominantly in UKPN's area, but the issue was applicable to all DNOs.
[16] SPMW successfully applied for additional allowances to deal with link boxes; Ofgem proposed a reduction to SPN's allowances, but subsequently decided not to make this adjustment.
[17] https://www.ofgem.gov.uk/publications-and-updates/decision-revise-allowed-expenditure-link-box-costs
[18] The size of the adjustment is calculated using a pre-determined unit cost, and the difference between actual volume delivery and the volumes DNOs are expected to deliver.

Proposed approach

5.6. While link boxes did not form part of the DPCR5 closeout process, the re-opener mechanism has a number of similarities to the general approach that was taken for other elements in DPCR5. Again, we have used the DPCR5 approach as a basis for our proposed methodology, building on it where necessary and simplifying it to follow a number of overarching principles. We have developed the proposed methodology in line with the requirements of the licence, as well as reflecting the approach to assessing volume delivery signalled in the decision for the 2017 reopener.

5.7. The detailed methodology is provided in Appendix 1. We have included a high-level summary of the proposed approach below:

- DNOs will provide Ofgem with a submission that outlines the approach they have adopted to manage the risk associated with link boxes, the actual volumes of work that have been carried out, and the associated costs.

- Ofgem will request any further information required, and will check whether the volumes of work reported by the DNO have been delivered, before comparing these with the volumes that were allowed for the price control.

- Based on this assessment, Ofgem will determine whether or not a DNO has delivered its link box replacement volumes and, therefore, the value of any adjustment to be made to revenues, assuming the materiality threshold has been passed.[19] This adjustment will then be spread across each year of RIIO-ED1, mirroring the timing profile of the original allowances, and have Time Value of Money adjustments applied.

- This resulting value will then be divided into two portions: one to adjust the DNO's RAV, and one to adjust the DNO's revenue in RIIO-ED2. Any revenue adjustments to the DNO's RIIO-ED2 revenue on account of 'catch up' for ED1 revenues will be spread equally across the five years of ED2.

5.8. As noted in other areas, Ofgem's assessment of volume delivery will cover the total volumes delivered.

Question 8: Do you agree with our proposal for assessing link box volume delivery?

[19] The materiality threshold for Link Boxes is a monetary value that the value of the adjustment must exceed. If it does not exceed this materiality threshold, then no adjustment will be made.

6. Shetland

Section summary

With recent developments surrounding the generation of electricity on Shetland maintaining uncertainty associated with the cost forecasts for RIIO-ED1, we introduced uncertainty mechanisms to cover the three cost categories. An adjustment will be made where costs are materially different from allowances.

Background to Shetland

6.1. Electricity on Shetland is generated entirely on the islands, with the majority coming from Lerwick Power Station (LPS), Sullom Voe Terminal Power Station, and Burradale Wind Farm. LPS is approaching the end of its operational life and, combined with expectations for it to exceed European emissions limits, a new solution will be needed.

6.2. Scottish Hydro Electric Power Distribution (SHEPD) ran a competitive process to find the best solution for ensuring security of supply on the islands. The preferred bid was a distribution link between the islands and the mainland, with a back-up diesel power station, for which we published a minded-to consultation approving these costs.

6.3. However, since then, there have been two external developments that necessitated reconsideration of the best solution. The first was the publication of a document in July 2017 that sits under the EU Industrial Emissions Directive (IED), and states that new, tougher emissions targets will only apply from 2030 (instead of 2020) for engines such as LPS. The second, in October 2017, was the Government's announcement that wind farms on remote islands (such as those on Shetland) will, subject to receiving State Aid approval, be eligible to compete for Contract for Difference (CfD) in the auction in 2019.

6.4. SHEPD investigated the options available as a result of these developments, and confirmed that security of supply can be provided until 2025 through a combination of LPS and supporting measures at a significantly lower cost than the original solution.[20]

Shetland reopeners

6.5. While the steps outlined in sub-paragraph 6.4 above produced an interim solution, there was still sufficient uncertainty around the cost forecasts out to 2023. We, therefore, introduced uncertainty mechanisms to cover three cost categories. The first is referred to as the Shetland Extension Fixed Energy Costs (SEFEC). A sub-component of these costs relate to the costs associated with providing a battery, as part of the interim solution; this second set of costs are known as the Shetland Extension Battery Costs

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[20] Decision on Shetland New Energy Solution: https://www.ofgem.gov.uk/system/files/docs/2017/11/shetland_new_energy_solution_decision_-_final_0.pdf

(SEBC). The third cost category covers costs known as the Shetland Enduring Solution Process Costs (SESPC). These costs are defined in CRC 3F.[21]

6.6. As in the case of other reopeners, any adjustment to allowances for SEFEC, SEBC or SESPC will only occur where costs are materially different from the baseline allowances. However, where the materiality test is not passed, any differences between actual expenditure and allowances will be subject to the TIM. There is no materiality threshold for downward adjustments to SEBC.

Proposed approach

6.7. While there is no DPCR5-related precedent for Shetland, there are a number of similarities to the general approach to re-openers that was taken in DPCR5. We have proposed the general approach adopted in DPCR5 and in other ED1 closeout mechanisms as a basis for Shetland, adjusting it where necessary. We have developed the proposed approach in line with the overarching principles applied in other areas of RIIO-ED1 closeout and consistent with licence requirements and relevant price control documentation.

6.8. The detailed methodology for SEFEC, SEBC and SESPC is provided in Appendix 1, with a high-level summary of the proposed approach given below:

- Either Ofgem or SHEPD may propose an adjustment to one or more of the three cost categories during windows after the end of the ED1 period, as specified in CRC 3F.

- Ofgem will check whether the costs that have been incurred represent efficient expenditure, and whether any further information is needed to make a decision. Where SHEPD provides notice of a proposed adjustment, Ofgem will check that the relevant notice has been provided during the specified window.

- Using the relevant notice, Ofgem will check whether the overall materiality threshold has been passed, before deciding whether to confirm, reject, or amend the adjustment proposed by SHEPD. If Ofgem proposes to confirm or amend the adjustment, or if it proposes an adjustment based on assessment of costs incurred, Ofgem will consult on that proposal before deciding what adjustment to make.

- This adjustment will then be spread across each year of RIIO-ED1, mirroring the timing profile of the original allowances, and have Time Value of Money adjustments applied.

- This resulting value will then be divided into two portions: one to adjust the DNO's RAV, and one to adjust the DNO's revenue in RIIO-ED2. Any revenue adjustments to the DNO's RIIO-ED2 revenue on account of 'catch up' for ED1 revenues will be spread equally across the five years of ED2.

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[21] SSEH's special licence conditions: https://epr.ofgem.gov.uk//Content/Documents/Scottish%20Hydro%20Electric%20Power%20Distribution%20Plc%20-%20Special%20Conditions%20Consolidated%20-%2018-12-2018%20-%20Current%20Version.pdf

6.9. Again, as with other areas, Ofgem's assessment of costs will cover the expenditure for these cost categories over the whole of RIIO-ED1.

Question 9: Do you agree with our proposal for assessing Shetland costs?

Technical Appendix 1: draft Legacy price control adjustments – financial methodologies

i) ED1 Load Related Re-opener - adjustment resulting from revised allowance levels upon Authority trigger

Overview

X.1 CRC 3G sets out a mechanism for revising the licensee's allowed level of Load Related Expenditure for the regulatory years 2015/16 to 2022/23, where its actual load related expenditure was higher or lower than its initial allowances and the test set out in CRC 3G.7 is met.

X.2 This section sets out the financial methodology the Authority will follow in determining any revisions to the licensee's opening RAV balance and base demand revenue for the ED2 Price Control Period under CRC 3G.20. Unless otherwise stated, where defined terms in this section were in use in the licence and Financial Handbook, those terms have the meaning given to them as defined in the latest versions of the licence condition and Financial Handbook.

Calculation of ED1 Load Related Re-opener revenue adjustment

X.3 CRC 3G.7 and 3G.10 necessitate that the Authority evaluate an efficient value of Load Related Expenditure for the regulatory years 2015/16 to 2022/23, known as TLRRCF (which is defined in CRC 3G.6(a) as "the level of efficient Load Related Expenditure over the Price Control Period"). Under CRC 3G.7, the value of TLRRCF is used for comparison with the opening level of allowed expenditure ($TLRRC_{ov}$) which, under CRC 3G.3, is defined by reference to the value of LRRC as defined in the latest version of the licence condition and before the Authority has made any revisions under Part A of CRC 3G.

X.4 The methodology that will be followed in evaluating TLRRCF is set out at Annex A: ED1 Load Related Re-opener Closeout Methodology.

X.5 If the Authority makes a determination under CRC 3G.20, that determination must specify revised values for the licensee's opening RAV balance and base demand revenue for the ED2 period (CRC 3G.20), and the years to which the determination applies (CRC 3G.24(a)). The Authority will undertake the steps, given in paragraph E.1 of Annex E, to calculate these values.

X.6 The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond.

ii) Net to gross adjustment for Load Related Expenditure

X.7 CRC 5G sets out a mechanism for revising the licensee's allowed level of Load Related Expenditure for the Regulatory Years 2015/16 to 2022/23, where the Authority has not given notice of proposed relevant adjustments under CRC 3G which, under CRC 5G.7, would preclude the Authority from making an adjustment under CRC 5G.

X.8 This section sets out the financial methodology the Authority will follow in determining any revisions to the licensee's opening RAV balance and base demand revenues for the ED2 Price Control Period under CRC 5G.14, after the end of the

Regulatory Year 2022/23. Unless otherwise stated, defined terms in this section have the meaning given to those terms in the latest version of the licence and Financial Handbook.

Calculation of ED1 Load Related Re-opener revenue adjustment

X.9 If, under CRC 5G.8, the licensee reports that its "*Relevant Expenditure has fallen outside a Specific Customer Funded Reinforcement Percentage Band*", CRC 5G.11 necessitates that the Authority evaluate whether the licensee has provided adequate justification. If the Authority determines the licensee has not provided adequate justification, it will determine the value of relevant adjustments. The methodology that will be followed in evaluating the licensee's justification is set out at Annex A.

X.10 If the Authority makes a determination under CRC 5G.14, having followed the procedure set out in CRC 5G Part C, that determination must specify any revisions that are to be made to the licensee's opening RAV balance and base demand revenue for the ED Price Control Period. The Authority will undertake the steps given in paragraph E.1 of Annex E to calculate this value.

iii) ED1 Network Asset Secondary Deliverables (NASD) adjustments

X.11 This section sets out the financial methodology the Authority will follow in determining revisions to the licensee's base demand revenue for the ED2 Price Control Period and revisions to ED2 opening RAV balance in respect of a licensee's delivery of Network Asset Secondary Deliverables (NASD) in ED1, as required by the latest version of licence condition CRC 5D of the ED1 licence.

X.12 The Authority's methodology for assessing delivery of NASD in ED1 is set out in Annex B – ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology.

X.13 If the Authority makes a determination under CRC 5D.9, that determination must specify revised values for the licensee's opening RAV balance and base demand revenue for the ED2 period, and set out the substance of the determination, specifying the date from which it will have effect (or a mechanism or method that will determine that date) (CRC 5G.13). The Authority will undertake the steps given in paragraph E.1 of Annex E to calculate these values.

X.14 If, under the Methodology set out in Annex C, the Authority determines that an ED1 NASD Allowance Adjustment Value is required, the Authority will obtain the ED1 NASD Allowance Adjustment Value from stage 7 of the ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology, and undertake the steps (ii) to (ix) given in paragraph E.1 of Annex E to calculate this value.

X.15 If under the Methodology set out in Annex C, the Authority determines that a penalty or reward is required, the Authority will apply the following steps:

i. Obtain the ED1 NASD Allowance Adjustment Value from stage 7 of the ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology.

ii. Multiply the value obtained in step (i) by 2.5 and divide by 100 to determine the reward or penalty value.

iii. Adjust the value calculated at (ii) to recognise the effect of inflation between the 2012/13 price base used in the ED1 Price Control Financial Model and the price base used in the ED2 Price Control Period, using:

a. Retail Price Inflation to translate the values to April 2023 prices, then

b. the relevant inflation measure for the ED2 Price Control Period to translate the values calculated at X.15 (iii)a to the relevant price base for the next Price Control Period.

iv. Split the total calculated at X.15 (iii)b into thirds, and apply Time Value of Money Adjustments to each third to reflect deferral to 2025/26, 2026/27 and 2027/28 respectively.

Determination of the ED1 NASD revenue and RAV adjustment values

X.16 As per CRC 5D.14, the Authority will give Notice to the licensee (and any other interested parties) of the proposed determination, allowing the licensee to make representations about the proposed determination which the Authority will consider.

X.17 No ED1 NASD revenue and RAV adjustment values for the licensee will be determined by the Authority by 30 November 2023 for the purpose of determining revised ED2 PCFM values by 30 November 2023.

X.18 The authority will use the methodology set out in this paragraph to determine ED1 NASD revenue and RAV adjustment values for the licensee by 30 November 2024 for the purpose of determining revised ED2 PCFM values by 30 November 2024.

X.19 No further revisions to the ED1 NASD revenue and RAV adjustment values for the licensee will be determined after 30 November 2024 for the purpose of determining revised ED2 PCFM values.

iv) ED1 High Value Projects (HVP) adjustments

Overview

X.20 CRC 3F sets out a mechanism for revising the licensee’s allowed level of High Value Project Costs upwards or downwards for the regulatory years 2015/16 to 2022/23. Revisions may reflect over or underspend on existing high-value investment projects, as long as the associated costs meet the definition of High Value Project Costs set out in CRC 1B.

X.21 This section sets out the financial methodology the Authority will follow in determining any revisions to the licensee’s Aggregate Baseline Expenditure Allowances for High Value Projects under CRC 3F.8, after the end of the regulatory year 2022/23. Unless otherwise stated, defined terms in this section have the meaning given to those terms in the latest version of the licence and Financial Handbook.

HVP Re-opener adjustment

X.22 Paragraph 3F.11 of CRC 3F specifies the window for the Authority to propose relevant adjustments. Appendix 1 of CRC 3F details the tests for any proposed relevant adjustments in relation to High Value Projects costs, as well as the relevant material amount for each licensee. This section deals only with adjustments at the end of the RIIO-ED1 period.

Calculation of RIIO-ED1 HVP Re-opener adjustment

X.23 CRC 3F.8, CRC 3F.9, and Appendix 1 of CRC 3F allow the Authority to determine an efficient adjustment to High Value Project Costs, or TUCHVPF (defined in A1.2 of CRC 3F as "*the proposed revised level of allowed expenditure that is defined as High Value Project Costs*"). Under Appendix 1 of CRC 3F, the value of TUCHVPF is used for comparison with the opening level of allowed expenditure (TUCHVPov), which is defined under Appendix 1 of CRC 3F as "*the total level of allowed expenditure that is defined as High Value Project Costs… plus any additional allowed expenditure determined under previous reopeners*". The methodology that will be followed by the Authority in evaluating TUCHVPF is set out at Annex D1: High Value Projects Closeout Methodology.

X.24 If the Authority makes a determination under CRC 3F.21 (or CRC 3F.29 for SSEH), that determination must specify the regulatory years to which the determination applies, and the revised total level of allowed expenditure for High Value Projects for each regulatory year. The Authority will undertake the steps, given in paragraph E.1 of Annex E, to calculate these values.

Determination of RIIO-ED1 HVP Re-opener adjustment value

X.25 The Authority will use any revised expenditure allowance amounts to determine the RIIO-ED1 HVP Re-opener adjustment values for the licensee by 30 November 2024, for the purpose of determining the value of revised PCFM values.

X.26 No further revisions to the RIIO-ED1 HVP Re-opener adjustment values for the licensee will be determined after 30 November 2024 for the purpose of determining revised RIIO-ED2 PCFM values, but this is without prejudice to any requirement for the licensee to restate the values referred to in paragraph X.24 for any other purpose.

v) ED1 Link Box Replacement adjustments (SPN and SPMW only)

X.27 The term Actual RIIO-ED1 Link Box Replacement Volumes means the number of Link Boxes replaced during RIIO-ED1.

X.28 The uncertainty mechanism provides for relevant adjustments in respect of the difference between Actual RIIO-ED1 Link Box Replacement Volumes and Allowed RIIO-ED1 Link Box Replacement Volumes. This mechanism applies to SPN and SPMW only.

The uncertainty mechanism for RIIO-ED1 Link Box Costs

X.29 By 31 July 2023, the licensee shall provide the Authority with a Performance Assessment Submission outlining the approach adopted in managing the asset risk associated with Link Boxes, its Actual RIIO-ED1 Link Box Replacement Volumes compared to its Allowed RIIO-ED1 Link Box Replacement Volumes, and its associated costs.

X.30 Once the Authority receives a record of the licensees' Actual RIIO-ED1 Link Box Replacement Volumes it will, by 30 November 2024, take the steps set out below to determine whether an adjustment should be made:

i. The Authority will check 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 within 10 working days of receipt of the licensee's Actual RIIO-ED1 Link Box Replacement Volumes.

It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further requests for information, analysis and reformatting. The licensee will have a minimum of 14 days to reply to all requests for further information, analysis or reformatting.

ii. The Authority will compare the information provided by the licensee on Actual RIIO-ED1 Link Box Replacement Volumes with the Allowed RIIO-ED1 Link Box Replacement Volumes outlined in Table X.1.

Table X.1 – Allowed RIIO-ED1 Link Box Replacement Volumes

	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	RIIO-ED1 total
SPMW	242	242	449	812	971	1,074	1,074	1,209	6,073
SPN	307	1,186	625	625	625	625	625	625	5,243

iii. Having carried out steps (i) and (ii) above, the Authority will determine whether:

a. the licensee has not delivered its Allowed RIIO-ED1 Link Box Replacement Volumes and an adjustment to allowed expenditure should be made if (Actual RIIO-ED1 Link Box Replacement Volumes – Allowed RIIO-ED1 Link Box Replacement Volumes) < 0; or

b. the licensee has delivered its Allowed RIIO-ED1 Link Box Replacement Volumes and no adjustment to allowed expenditure should be made if (Actual RIIO-ED1 Link Box Replacement Volumes – Allowed RIIO-ED1 Link Box Replacement Volumes) ≥ 0.

X.31 If the Authority determines the RIIO-ED1 Link Box Replacement Volumes have not been delivered it will determine the adjustments to the licensee's allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied. The Authority will calculate the amount of any adjustment using the volume not delivered multiplied by the unit cost values as outlined in Table X.2. The Authority will undertake the steps, given in paragraph E.1 of Annex E, to calculate these values.

X.32 If the Authority decides the licensee has delivered its Allowed RIIO-ED1 Link Box Replacement Volumes, no adjustments will be made.

X.33 The Authority will check whether the Link Box Closeout materiality threshold has been passed in accordance with paragraph X.34. If it has not, it will not make a relevant adjustment.

Table X.2 – Unit costs for determining relevant adjustments in respect of RIIO-ED1 Link Box Replacement Volumes (12/13 prices)

	Unit cost (12/13 prices)
Link Box Connection	£5,700

Link Box Closeout materiality threshold

X.34 A Link Box Closeout Materiality Threshold applies to the proposed adjustment. The materiality threshold for the licensee, in 2012/13 prices, is specified in

Table X.3 of this subsection. If the proposed adjustment does not exceed this threshold, then no adjustment will be made.

Determination of a relevant adjustment

X.35 The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond. A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of RIIO-ED1 Link Box Replacement Volumes will specify:

i. the Regulatory Years to which the determination applies; and
ii. the revised total amounts of allowed Totex expenditure (in 2012/13 prices) for each of the Regulatory Years.

X.36 If the Authority does not make a relevant adjustment determination within four months of receiving the licensee's Actual RIIO-ED1 Link Box Replacement Volumes, then no adjustment will be made to the licensee's allowances.

X.37 The Authority will use any revised expenditure allowance amounts to determine the UCLB values for the licensee by 30 November 2024, for the purpose of determining the value of revised PCFM values.

X.38 Subject to paragraph X.36, no further revisions to the UCLB values for the licensee will be determined after 30 November 2024 for the purpose of determining revised RIIO-ED2 PCFM values.

Table X.3: Materiality Threshold for RIIO-ED1 Link Box Replacement Volumes (£m, in 2012/13 prices)

Materiality Threshold
0.2

vi) ED1 Shetland Extension Fixed Energy Costs and Shetland Extension Battery Costs Adjustments (SSEH only)

Overview

X.39 CRC 3F sets out a mechanism for revising SSEH's allowed level of Shetland Extension Fixed Energy Costs (UCSEFEC) and Shetland Extension Battery Costs (UCSEBC) expenditure at the end of the price control period. CRC 3F.12 and CRC 3F.13 provide the application windows for the licensee to propose adjustments in respect of UCSEFEC and UCSEBC respectively. CRC 3F.25 provides a window for the Authority to give the licensee Notice of its intention to make an adjustment to UCSEFEC and/or UCSEBC.

X.40 This chapter sets out the financial methodology the Authority will follow in determining any revisions to the licensee's opening RAV balance and base demand revenue for the ED2 Price Control Period under CRC 3F.15, CRC 3F.22, or CRC 3F.26, after the end of Regulatory Year 2022/23. Unless otherwise stated, where defined terms in this Chapter were in the licence and Financial Handbook in the form it was in as defined in the latest version of the licence condition, those terms have the meaning given to them at that time.

X.41 The term UCSEFEC means costs incurred, or expected to be incurred by SSEH in managing an extension of services to meet electricity demand on Shetland to 2023, to the extent that those costs are not otherwise recoverable under the Charge Restriction Conditions of the licence. The term UCSEBC means a sub-component of those costs specifically in relation to the costs associated with providing a battery as part of the interim solution. These definitions are set out in CRC 3F.38.

X.42 The uncertainty mechanisms provide for relevant adjustments to levels of allowed expenditure for both cost terms for Regulatory Year 2019/20 to Regulatory Year 2022/23 in respect of:

i. efficient costs that were not included in the calculation of Opening Base Revenue Allowances for SSEH;

ii. efficient costs that are not subject to pass-through provisions in CRC 2B; and

iii. Shetland Extension Fixed Energy Costs that are materially lower or higher than expected levels of actual expenditure (with respect to proposals made by the Authority or SSEH); or

iv. Shetland Extension Battery Costs where these costs are materially higher (with respect to proposals made by SSEH) or materially lower (with respect to proposals made by the Authority) than expected levels of actual expenditure. Where costs are lower, there is no material amount required to trigger an adjustment (the material amount is zero).

The uncertainty mechanism for Shetland Extension Fixed Energy Costs

Determination of a relevant adjustment for Shetland Extension Fixed Energy Costs proposed by the licensee

X.43 If the Authority receives Notice of a proposed relevant adjustment from the licensee, in respect of Shetland Extension Fixed Energy 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 window referred to in paragraph X.39. If the Notice has been received before 1 September 2023, the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during September 2023. If the Notice has been received after 30 September 2023, 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.31 and 3F.32 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 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 specified in paragraph 3F.16 of CRC 3F, within 10 working days of receipt of a proposal under paragraph CRC 3F.12 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 X.51, X.53 and X.54. If it has not been passed, then no relevant adjustment will be made.

v. Having carried out steps (i) to (iv) above, in the case of a proposal from the licensee 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 confirm or amend 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 X.42.

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.

Determination of a relevant adjustment for the Shetland Extension Fixed Energy Costs proposed by the Authority

X.44 The Authority will assess the licensee's level of Shetland Extension Fixed Energy Costs prior to the window set out in paragraph CRC 3F.25, and will use this assessment to inform its decision on whether or not to give Notice under CRC 3F.23. In undertaking this assessment, the Authority will consider whether the licensee's Actual Shetland Extension Fixed Energy Costs are materially different (as per the materiality threshold specified in X.51) from the total Shetland Extension Fixed Energy Costs allowance value, based on the information available to the Authority at the time. This information will include, but not be limited to, ED1 RIGs submissions and any other relevant submissions made by the licensee during or after the ED1 Price Control Period.

X.45 Any proposal made by the Authority must comply with the requirements of CRC 3F.31 and CRC 3F.32. The Authority will apportion any proposed adjustment to Regulatory Years 2019/20 to 2022/23 in line with the timing profile of the licensee's UCSEFEC values.

X.46 On giving Notice of a proposed relevant adjustment, the Authority will follow the steps set out in CRC 3F.28, and will then make a relevant adjustment determination.

The uncertainty mechanism for the Shetland Extension Battery Costs

Determination of a relevant adjustment for the Shetland Extension Battery Costs proposed by the licensee

X.47 Once the Authority receives Notice of a proposed relevant adjustment by the licensee and complete record of the licensee's Shetland Extension Battery Costs, it will take the steps set out below to determine whether the proposed adjustment should be made:

i. The Authority will check whether the Notice has been received during the window referred to in paragraph X.39. If the Notice has been received before 1 July 2023, the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during July 2023. If the Notice has been received after 31 July 2023, 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.31 and 3F.32 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 represent a necessary and efficient level of expenditure.

iii. The Authority will check 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 under paragraph 3F.16 of CRC 3F, within 10 working days of a receipt of a proposal under paragraph CRC 3F.13.

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 X.52 to X.54 for the proposed relevant adjustments for Shetland Extension Battery Costs. If it has not, then no relevant adjustment will be made.

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

(a) the licensee has not spent its Shetland Extension Battery Costs, or whether the licensee has spent its Shetland Extension Battery Costs and the materiality threshold has been passed, and whether to reject, confirm or amend the relevant adjustment proposed by the licensee, and an adjustment to allowed expenditure should be made; or

(b) the licensee has spent its Shetland Extension Battery Costs and the materiality threshold has not been passed and thus that no adjustment to allowed expenditure should be made.

If the Authority determines the Shetland Extension Battery Costs have not been spent, or that the licensee has spent its Shetland Extension Battery costs and the materiality threshold has been passed, and it decides to confirm or amend 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, having regard to paragraph X.42.

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 other respondents and will then make a relevant adjustment determination.

Determination of a relevant adjustment for the Shetland Extension Battery Costs proposed by the Authority

X.48 The Authority will assess the licensee's level of Shetland Extension Battery Costs prior to the window set out in paragraph CRC 3F.23, and will use this assessment to inform its decision on whether or not to give Notice under CRC 3F.25. In undertaking this assessment, the Authority will consider whether the licensee's Actual Shetland Extension Battery Costs are lower than the total Shetland Extension Battery Costs allowance value for the Regulatory Years 2019/20 to 2022/23, based on the information available to the Authority at the time. This information will include, but not be limited to, ED1 RIGs submissions, the complete record of Shetland Extension Battery Costs, and any other relevant submissions made by the licensee during or after the ED1 Price Control Period.

X.49 Any proposal made by the Authority must comply with the requirements of CRC 3F.31 and CRC 3F.32. The Authority will apportion any proposed adjustment to Regulatory Years 2019/20 to 2022/23 in line with the timing profile of the licensee's UCSEBC values.

X.50 On giving Notice of a proposed relevant adjustment, the Authority will follow the steps set out in CRC 3F.28, and will then make a relevant adjustment determination.

Overall materiality threshold

Determination of a relevant adjustment for the Shetland Extension Battery Costs and Shetland Extension Fixed Energy Costs

X.51 An overall materiality threshold applies in respect of relevant adjustments for the Shetland Extension Fixed Energy Costs, whether proposed by the licensee or the Authority. The materiality threshold for the licensee, in 2012/13 prices, is specified in Appendix 9 to CRC 3F.

X.52 An overall materiality threshold applies in respect of relevant adjustments for the Shetland Extension Battery Costs, where proposed by the licensee but only where the expenditure is materially higher than expected levels of actual expenditure. The materiality threshold for the licensee, in 2012/13 prices, is specified in Appendix 11 to CRC 3F. For UCSEBC, the materiality threshold for any downward adjustment is zero.

X.53 If the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, the materiality threshold is not further taken into account in the determination of relevant adjustments to allowed expenditure levels. This applies to the respective proposed adjustment and materiality threshold for both UCSEFEC and UCSEBC.

X.54 If 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. This applies to the respective proposed adjustment and materiality threshold for both UCSEFEC and UCSEBC. For UCSEBC, the materiality threshold for any downward adjustment is zero.

Determination of a relevant adjustment

X.55 A determination by the Authority that makes a relevant adjustment in respect of Shetland Extension Fixed Energy Costs and/or Shetland Extension Battery 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.

X.56 If the Authority does not make a relevant adjustment determination within four months of the close of the application window, then paragraph 3F.22 of CRC 3F stipulates that the adjustment will be deemed to have been made.

X.57 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSEFEC and / or UCSEBC values under paragraph X.72 of this chapter.

vii) ED1 Shetland Enduring Solution Process Costs adjustments (SSEH only)

Overview

X.58 CRC 3F sets out a mechanism for revising SSEH's allowed level of Shetland Enduring Solution Process Costs (UCSESPC) expenditure at the end of the ED1 Price Control period. CRC 3F.12 provides the application window for the licensee to propose adjustments in respect of UCSESPC. CRC 3F.25 provides a window for the Authority to give the licensee Notice of its intention to make an adjustment to UCSESPC.

X.59 This chapter sets out the financial methodology the Authority will follow in determining any revisions to the licensee's opening RAV balance and base demand revenue for the ED2 Price Control Period under CRC 3F.15, CRC 3F.22, or CRC 3F.26, after the end of Regulatory Year 2022/23. Unless otherwise stated, where defined terms in this Chapter were in use in the licence and Financial Handbook in the form it was in at 1 April 2015, those terms have the meaning given to them as defined in the latest version of the licence condition and Financial Handbook.

X.60 The term UCSESPC means costs incurred, or expected to be incurred by SSEH for identifying and procuring an enduring solution for Shetland, in implementing its obligations under CRC 2Q and further to 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.38.

X.61 This uncertainty mechanism provides for relevant adjustments to levels of allowed expenditure for Regulatory Year 2019/20 to Regulatory Year 2022/23 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).

The uncertainty mechanism for Shetland Enduring Solution Process Costs

Determination of a relevant adjustment proposed by the licensee

X.62 If the Authority receives Notice of a proposed relevant adjustment from the licensee, in respect of Shetland Enduring Solution Process Costs it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended:

i. In the case of a proposal from the licensee, the Authority will check whether the Notice has been received during the window referred to in CRC 3F.25. If the Notice has been received before 1 September 2023 the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during September 2023. If the Notice has been received after 30 September 2023 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, 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 specified in paragraph CRC 3F.16, within 10 working days of receipt of a proposal under paragraph CRC 3F.12.

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 X.66 to X.68. If it has not been passed, then no relevant adjustment will be made.

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 X.61.

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.

Determination of a relevant adjustment proposed by the Authority

X.63 The Authority will assess the licensee's level of Shetland Enduring Solution Process Costs prior to the window set out in CRC 3F.25, and will use this assessment to inform its decision on whether or not to give Notice under CRC 3F.23. This notice must be given during September 2023. In undertaking this assessment, the Authority will consider whether the licensee's actual Shetland Enduring Solution Process Costs are materially different (as per the materiality threshold specified in X.66) from the total Shetland Enduring Solution Process Costs allowance value, based on the information available to the Authority at the time. This information will include, but not be limited to, ED1 RIGs submissions and any other relevant submissions made by the licensee during or after the ED1 Price Control Period.

X.64 Any proposal made by the Authority must comply with the requirements of CRC 3F.31 and CRC 3F.32. The Authority will apportion any proposed adjustment to Regulatory Years 2019/20 to 2022/23 in line with the timing profile of the licensee's UCSESPC values.

X.65 On giving Notice of a proposed relevant adjustment, the Authority will follow the steps set out in CRC 3F.28, and will then make a relevant adjustment determination.

Overall materiality threshold

X.66 An overall materiality threshold applies in respect of relevant adjustments for Shetland Enduring Solution 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 10 to CRC 3F.

X.67 If the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, the materiality threshold is not further taken into account in the determination of relevant adjustments to allowed expenditure levels.

X.68 If 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

X.69 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Shetland Enduring Solution 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.

X.70 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Shetland Enduring Solution 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.22 of CRC 3F stipulates that the adjustment will be deemed to have been made.

X.71 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSESPC values under section X.72 of this chapter.

viii) Calculation of revenue adjustments for Shetland Extension Fixed Energy Costs, Shetland Extension Battery Costs, and Shetland Enduring Solution Process Costs Re-openers

X.72 CRC 3F.12, CRC 3F.13 and CRC 3F.23 allow the licensee and the Authority to propose relevant adjustments for Shetland Extension Fixed Energy Costs (UCSEFEC values), Shetland Extension Battery Costs (UCSEBC values), and Shetland Enduring Solution Process Costs (UCSESPC values)

X.73 If the Authority determines one or more relevant adjustments for Shetland Extension Fixed Energy Costs, Shetland Extension Battery Costs, or Shetland Enduring Solution Process Costs under CRC 3F.15 or CRC 3F.26, or an adjustment is deemed to have been made under CRC 3F.22, the Authority must specify revised values for the licensee’s opening RAV balance and base demand revenue for the ED2 Price Control Period, and the years to which the determination(s) apply.

X.74 The Authority will undertake the steps given in paragraph E.1 of Annex E to calculate these values.

Annex A: ED1 Load Related Re-opener Closeout Methodology

Overview

A.1 This Annex sets out how the Authority will assess the licensee's total level of efficient Load Related Expenditure over the ED1 Price Control Period (TLRRCF, the total over the ED1 Price Control Period of the licensee's LRRCF, as that acronym is defined in CRC 3G.6a) for the purpose of determinations under CRC3G.20.

A.2 The Authority will carry out the following steps to determine TLRRCF:

- Step 1: Initial High Level Analysis
- Step 2: Performance Assessment Submission
- Step 3: Efficiency assessment
- Step 4: Assessment of expenditure avoided through innovation
- Step 5: Evaluation of TLRRCF

Step 1: Initial High Level Analysis

A.3 The Authority will carry out an initial assessment of the licensee's TLRRCF prior to the window set out in CRC 3G.16, and will use this assessment to inform its decision on whether or not to give a Notice under CRC 3G.6.

A.4 In undertaking this analysis, the Authority will consider the licensee's Actual Load Related Expenditure on the basis set out in CRC 3G.11. For example, this may include an adjustment for avoided expenditure as a result of non-traditional solutions, to the extent this is possible based on the information available to the Authority at the time (this will include, but is not be limited to, ED1 RIGs submissions and any other relevant submissions made by the licensee).

A.5 The Authority will inform the licensee of the results of the Initial High Level Analysis, including where those results indicate that no reopener is necessary and therefore no Notice under CRC 3G.6 will be given. Where it also gives a Notice under CRC 3G.6, in accordance with the timescales specified in CRC 3G.16, it will specify any further information or analysis that it reasonably considers is required in order to assess TLRRCF, which the licensee will be required to provide as part of its Performance Assessment Submission.

Step 2: Performance Assessment Submission

A.6 Where the licensee is required to submit further information or analysis in relation to a Notice under CRC 3G.6, or where the licensee considers that further information or analysis would be relevant following a Notice under CRC 3G.6, it will provide this information in a Performance Assessment Submission by 31 December 2023. The scope of the Performance Assessment Submission, and the process by which the Authority may request additional information, is set out in Annex E.

Step 3: Efficiency Assessment

A.7 CRC 3G.6(a) defines LRRCF as "the level of efficient Load Related Expenditure over the Price Control Period". The Authority will therefore assess the efficiency of the licensee's Load Related Expenditure in the Price Control Period, taking into account all information submitted by the licensee in its Performance Assessment Submission.

A.8 In undertaking its assessment of the licensee’s expenditure, the Authority will interpret efficiency to mean investment decision making by a licensee that:

i. took into account all the information that could reasonably have been expected to have been available to the licensee at the time of making the relevant decisions; and,

ii. resulted in expenditure during the Price Control Period that would reasonably, at the time of making the relevant decisions, have been expected to be required to meet the changing and uncertain needs and requirements of the licensee’s electricity distribution system.

A.9 Subject to paragraph A.8, the Authority’s view of TLRRCF will be equal to the licensee’s, unless:

i. The Authority identifies schemes, programmes or items of Load Related Expenditure within the Price Control Period which the Authority deems not to be efficient; and,

ii. the licensee has not provided a supporting explanation which is adequate in the Authority’s view.

A.10 Where an efficiency adjustment is made, its value will be limited to the value of the factors identified under paragraph A.9. No adjustment will be made on account of other bases of efficiency assessment, such as unit cost analysis.

A.11 Subject to paragraph A.8, in assessing “efficiency” the Authority will consider:

i. how the decision making processes and procedures of the licensee were used and executed in practice, including key drivers and investment decision making; and

ii. a review of selected specific schemes, including consideration of the needs case (with reference to Load Indices where appropriate), changes in requirements or justifications and other options considered by the licensee.

Step 4: Assessment of expenditure avoided through innovation

A.12 CRC 3G.11(d) requires that all calculations under CRC 3G be undertaken “*net of an* adjustment *for any expenditures avoided, or that may reasonably be expected to be or to have been avoided, as a result of demand-side response or other non-traditional solutions to load related issues*”.

A.13 In accordance with the requirement in CRC 3G.11(d), the Authority will take into account efficiencies generated by the licensee through the use of Innovative Solutions in its evaluation of TLRRCF. In performing this assessment, the Authority will take into account evidence which may include, but is not limited to, the following:

i. cost-benefit or other financial analysis submitted by the licensee demonstrating the saving that resulted from the solution adopted by the licensee compared to alternative solutions, including conventional solutions, beyond those savings that were included in the licensee’s business plan and including information explaining and justifying any assumptions that have been made;

ii. evidence provided by the licensee that the solution deployed meets the criteria defined as Innovative Solutions in the latest version of Annex A of the RIGs.

A.14 Where the Authority's assessment at A.13 indicates that the licensee generated relevant efficiencies through the use of Innovative Solutions, the Authority will add to its evaluation of TLRRCF:

i. the Authority's assessment of the expenditure the licensee would have incurred in the absence of Innovative Solutions, where possible referencing the licensee's "E6 – Innovative Solutions" submissions as described in Annex J of the RIGs; less

ii. the costs that were incurred by the licensee in delivering the Innovative Solution, where possible referencing the licensee's "E6 – Innovative Solutions" submissions as described in Annex J of the RIGs.

Step 5: Evaluation of TLRRCF

A.15 In making its evaluation of TLRRCF, the Authority will undertake the calculation on the basis set out in CRC 3G.6(a), CRC 3G.11 and CRC 3G.12, and will therefore subtract any efficiency and add any innovation adjustment in accordance with steps 4 and 5 above.

Annex B: ED1 Net to Gross Assessment Methodology

Overview

B.1 This Annex sets out how the Authority will determine the relevant adjustments to the licensee's RAV and Base Demand Revenue in the ED2 Price Control Period, where the Actual Percentage of Gross Load Related Expenditure provided by Specific Customer Funded Reinforcement during the ED1 Price Control Period falls outside the Specific Customer Funded Reinforcement Percentage Band, as defined in CRC 5G.

B.2 CRC 5G.8 places the onus on licensees to provide the justification for not making relevant adjustments. In accordance with CRC 5G.7, where the Authority gives Notice of proposed relevant adjustments under CRC 3G, no such justification is required and the Authority will not carry out a specific assessment of net-to-gross relevant adjustments.

B.3 Where a net-to-gross assessment is required, the methodology will consist of two main steps:

- Step 1: Licensee performance report
- Step 2: Authority assessment of justification

Step 1: Licensee performance report

B.4 CRC 5G.8 specifies that the licensee must provide a report on 31 July 2023 where its Relevant Expenditure has fallen outside a Specific Customer Funded Reinforcement Percentage Band, as specified in Table 2 of CRC 5G.

B.5 In order for the licensee to determine if it has fallen outside the Specific Customer Funded Reinforcement Percentage Band, the licensee should calculate the Actual Percentage of Gross Load Related Expenditure delivered through Specific Customer Funded Reinforcement.

B.6 This could result in the actual percentage being either above the upper threshold or below the lower threshold specified in Table 2 of CRC 5G. A report is required when either situation arises.

B.7 CRC 5G.9 specifies the type of information required within the report. In preparing the report, the licensee may need to make reference to Tables 1 to 5 of CRC 5G.

B.8 The licensee's report may draw on numerical comparisons of actual values compared to the baseline values in the reference tables, and will be supplemented by narrative providing the justification for being outside of the Specific Customer Funded Reinforcement Percentage Band.

Step 2: Authority assessment of justification

B.9 The Authority will review the data and justification provided by the licensee, alongside other relevant information to carry out a qualitative assessment of whether the justification provided by the licensee adequately explains why the actual Customer Funded Reinforcement Percentage is outside the Specific Customer Funded Reinforcement Percentage Band.

B.10 In reaching its decision about whether a relevant adjustment is required, the Authority will consider:

- Changes to the volumes and mix of connection projects;
- Changes to the Actual Customer Funded Reinforcement expenditure;
- Changes to the Actual Gross Load Related Reinforcement expenditure;
- The elements under the control of the licensee; and
- The circumstances outside of the control of the licensee.

B.11 Due to the complexity of a number of different parameters affecting the outcome, there is no simple mechanistic calculation that can be performed. The Authority will need to review the justification provided by the licensee and determine whether there is sufficient justification not to determine relevant adjustments.

B.12 Where the Authority concludes that insufficient justification has been provided, it will determine the relevant adjustments as specified in CRC 5G.11. CRC 5G.11 does not specify how the Authority will determine the value of any relevant adjustments. The approach will be determined by the circumstances for each licensee, and could result in either a positive or negative value of relevant adjustments.

Annex C: ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology

Overview

C.1 The ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology sets out the way in which the Authority will determine:

i. whether the licensee has delivered its ED1 NASD target;

ii. whether the licensee has a justified over-delivery of ED1 NASD;

iii. whether the licensee has an unjustified under-delivery of ED1 NASD;

iv. the value of the justified over-delivery or unjustified under-delivery of ED1 NASD, if any; and

v. the value of any associated reward for justified over-delivery or penalty for unjustified under-delivery.

C.2 This methodology is based on the requirements of Electricity Distribution License Charge Restriction Condition (CRC) 5D, which specifies the incentive arrangements and the Network Output Measures (NOMs) Incentive Methodology, which provides a common high level framework across gas and electricity, transmission and distribution sectors in the RIIO-1 price controls. For Electricity Distribution, NOMs are referred to as NASD in ED1.

C.3 As part of its ED1 settlement the licensee committed to delivering a NASD monetised risk target representing the monetised risk change resulting from:

i. Asset Replacement;

ii. Asset Refurbishment; and,

iii. (if applicable) High Value Projects for asset replacement or refurbishment.

for a specified subset of asset categories.

C.4 The targets for the Electricity Distribution sector represent the change in monetised risk at a network level aggregated from the change in monetised risk specified for a subset of asset categories. In ED1, each licensee had the scope to specify which asset categories would be included within its own targets and consequently there is variation across the licensees.

C.5 CRC 5D states that the targets are specified for each licensee within Network Asset Workbooks (NAW). The NAW only specifies asset profiles, and is therefore supplemented by Monetised Risk Workbooks that convert asset profiles into monetised risk values.

C.6 The change in monetised risk is derived from the difference between two positions at the end of the ED1 price control:

- Monetised risk without intervention; and
- Monetised risk with intervention.

This difference leads to a reduction in monetised risk associated with asset replacement, refurbishment and High Value Projects (for asset replacement or refurbishment) activities for specified asset categories.

C.7 The NASD targets to be used for the assessment of the delivery of NASD are the NAW and Monetised Risk Workbook for each licensee, as published alongside the Authority's decision document published on 5 May 2017,[22] or subsequent revisions to these targets, where the Authority approves such revisions.

C.8 The NASD targets published on 5 May 2017 represent the Rebased NASD targets submitted by the licensees to implement the Common Network Asset Indices Methodology (CNAIM) as required by Part C of CRC 5D. The original targets submitted by licensees with their ED1 business plans were based on licensees' own network asset indices methodologies. The original targets were translated into the rebased NASD targets during 2016, once the CNAIM was approved on 1 February 2016.

C.9 CRC 5D specifies that adjustments will be made to ED2 revenues for justified over-delivery and unjustified under-delivery. Justified over-delivery will also be subject to a 2.5% reward, while unjustified under-delivery will be subject to a 2.5% penalty.

C.10 CRC 5D also recognises circumstances can change and that licensees may trade off monetised risk between types of intervention and asset categories in order to deliver an equivalent level of monetised risk through a different pattern of interventions from those assumed in the published NAW documents.

C.11 Part A of CRC 5D requires licensees to submit a report by 31 July 2023 setting out the licensees' performance against NASD targets over the ED1 price control period. This Performance Report will be used alongside the data provided in annual submissions of RIGs Secondary Deliverables Reporting Pack, associated commentaries and other relevant data sources to carry out quantitative and qualitative assessments of the licensees' performance.

C.12 The process to be followed is based on the framework described in Section 3 of the NOMs Incentive Methodology[23] and summarised below:

- Stage 1: Licensee submits relevant Non-NASDs risk changes and impact on performance against targets
- Stage 2: Licensee submits ED1 Performance Report
- Stage 3: The Authority assesses the relevant risk changes and Performance Report
- Stage 4:The Authority assesses delivery against the NASD monetised risk target
- Stage 5: Licensee provides justification (if not already provided as part of stage 1 and 2)
- Stage 6: The Authority assesses the justification evidence
- Stage 7: The Authority determines the value of the adjustments required

C.13 Throughout the process the Authority has the scope to ask for clarification or additional details through supplementary questions.

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[22] https://www.ofgem.gov.uk/publications-and-updates/network-asset-secondary-deliverables-rebasing-decision

[23] https://www.ofgem.gov.uk/system/files/docs/2018/12/network_output_measures_noms_incentive_methodology_.pdf

C.14 Any determination by the Authority which is related to High Value Project costs or Link Box costs under licence condition CRC 3F will need to be considered alongside this methodology to avoid double counting adjustments related to delivery of NASD. The conclusions of the determinations under CRC 3F will inform any adjustments to be applied under this methodology.

Stage 1 - Licensee submits relevant Non-NASDs risk changes and impact on performance against targets

C.15 Stage 1 of the NOMs Incentive Methodology, on which the NASD methodology is based, requires the licensee to submit details of relevant risk changes that have impacted the delivery of its monetised risk target, along with evidence of how these risk changes have arisen.

C.16 Risk changes are 'relevant' where the licensee deems that they have had a significant impact on the delivery of the NASD monetised risk target. The scope and materiality of the details of relevant risk changes is at the discretion of the licensee, but should be proportionate to the impact those relevant risk changes have had on the delivery of the NASD monetised risk target. Limiting this analysis reduces the burden of evidence required to be produced by the licensee and the amount of review required by the Authority.

C.17 These details are to be provided as part of the Performance Report required under stage 2.

C.18 Throughout the ED1 period, licensees will submit RIGs Annex D data templates. These templates contain the net movements across the risk matrices for asset categories associated with Health Index categories included in each licensee's NASD targets.

C.19 The movements are disaggregated into the following categories:

- Starting point
- Movements due to data cleansing (caused by asset register volume changes)
- Movements due to deterioration (observed changes to the condition of the assets)
- Movements due to other non-intervention changes (observed changes to criticality of assets or revisions to calculations or methodology)
- Movements due to asset replacement
- Movements due to refurbishment
- Movements due to general reinforcement
- Movements due to faults
- Movements due to High Value Projects (with asset replacement or refurbishment)
- Movements due to High Value Projects (other drivers)
- Movements due to other investment activities
- Closing balance

C.20 These movements can be grouped into three higher-level categories:

NOMs (NASD) risk movements	Non-NOMs (NASD) risk movements	
NOMs (NASD) intervention movements	**Non-NOMs (NASD) intervention movements**	**Non-intervention movements**
• Asset replacement • Refurbishment • High Value Projects (with asset replacement/ refurbishment)	• General reinforcement • Faults • High Value Projects (other drivers) • Other investment activities	• Data cleansing • Deterioration • Other non-intervention changes
Contribute to NASD delivery	Potential relevant risk changes	Potential relevant risk changes

C.21 NOMs (NASD) intervention movements are those changes in monetised risk that are related to the investment activities that contribute towards the delivery of the NASD targets (i.e. asset replacement, asset refurbishment and High Value Projects (for asset replacement or refurbishment)).

C.22 Non-NOMs (NASD) intervention movements are those changes in risk that are related to investment activities that do not contribute towards the delivery of the NASD targets (i.e. reinforcement, faults, High Value Projects (not related to asset replacement or refurbishment) and all other activity).

C.23 Non-intervention movements relate to changes in risk that are caused by data cleansing of asset volumes, deterioration of asset condition and other non-intervention risk changes such as changes to asset criticality.

C.24 Whilst Non-NOMs (NASD) intervention risk changes and Non-intervention risk changes do not contribute to the delivery of NASD targets, they can affect the scale of activity that is carried out. They therefore may have a relevance to the ability of the licensee to deliver the NASD monetised risk target.

C.25 Within this stage of the process, the licensee may provide analysis that illustrates how, in the view of the licensee, Non-NOMs (NASD) intervention risk changes and Non-intervention risk changes have impacted its delivery of NASD targets.

Stage 2 - Licensee submits ED1 Performance Report

C.26 CRC 5D.3 requires the licensee to submit a Performance Report which must include (where relevant) detailed explanations together with all appropriate supporting evidence for:

(a) the licensee’s performance against its Network Asset Secondary Deliverables;

(b) any performance against its Network Asset Secondary Deliverables equivalent to or better than that set out in the Network Assets Workbook (and converted to monetised risk measures in the Monetised Risk Workbook);

(c) any Justified Over-Delivery against its Network Asset Secondary Deliverables; and

(d) any Justified Under-Delivery against its Network Asset Secondary Deliverables.

C.27 The CRC 5D.3 reporting requirement incorporates justification and therefore overlaps with the requirements of stage 5 of the high-level framework in the NOMs Incentive Methodology. Licensees will therefore be providing some justification as part of the Performance Report, which may (if required) be supplemented with further justification provided under stage 5.

C.28 The scope of content of the Performance Report is covered in Annex E of this document.

Stage 3 – Authority assessment of the relevant risk changes and Performance Report

C.29 The Authority will review the details of relevant risk changes and performance delivery in the licensee's Performance Report and where necessary the Authority may ask supplementary questions if there are ambiguities in the information provided or areas where further clarification is required. The Authority may also require the licensee to resubmit data.

C.30 The Authority will assess the licensee's view of delivery against the NASD monetised risk targets to determine whether it agrees with the licensee's view of delivery. This may require cross-checking data with submitted RIGs Annex D Secondary Deliverables data templates and other relevant information.

C.31 The Authority will also assess the licensee's view of the impact of relevant risk changes to determine whether the identified risk movements associated with non-NOMs (NASD) interventions and non-intervention risk changes have impacted the delivery of the NASD target. This analysis may be carried out at individual asset category levels to gain an understanding of how the changes have impacted overall delivery of the NASD monetised risk target.

C.32 The outcome from this stage will be a reference dataset that clearly identifies the impact of relevant risk changes on the delivery against the licensee's NASD target, and the licensee's delivery of NASD monetised risk.

Stage 4 - The Authority assesses delivery against the NASD monetised risk target

C.33 The Authority will compare the licensee's network-wide monetised risk delivery against the licensee's NASD monetised risk target to determine whether the target has been delivered.

C.34 The monetised risk delivery will be converted to a percentage delivery.

C.35 Delivery is deemed to be on target where the performance is within a materiality threshold (deadband), which for Electricity Distribution will be determined when we have a better understanding of the degree of robustness of the data that will support Licensees' performance on NASDs outputs.

C.36 If a licensee's performance falls within the materiality threshold there is no NOMs incentive mechanism revenue adjustment. The assessment process stops.

C.37 If a licensee's performance falls outside the materiality threshold, then the remainder of the process continues to determine the value of the revenue and RAV adjustments.

C.38 The Authority will provide a notice specifying which licensees have delivered on-target (i.e. within the materiality thresholds) and which are required to provide justification for over-delivery or under-delivery. This notice will be issued by 30 November 2023. If there is a delay to providing this notice, all subsequent action deadlines may be revised in line with the length of delay.

Stage 5: Licensee provides justification (or supplements justification provided as part of stage 1 and 2).

C.39 Where the Authority indicates that a licensee has delivered performance outside of the materiality thresholds, the licensee will be required to provide justification for the variance to NASD monetised risk target.

C.40 The licensee may have provided some justification as part of the performance submission under stage 2, but the licensee will be given the opportunity to supplement the original submission with further justification.

C.41 The extent and nature of the justification and evidence is not prescribed in the NOMs Incentive Methodology. However, the justification provided should be proportionate to the difference between the ED1 performance and the NASD monetised risk target and it is noted that for Electricity Distribution, there is extensive data available from submitted RIGs Annex D Secondary Deliverable data templates and RIGs Annex B Costs and Volumes, to which licensees will be able to refer.

C.42 CRC 5D provides definitions of Justified Over-Delivery and Justified Under-Delivery.

C.43 Parts (a) of these definitions suggest that justification of under-delivery or over-delivery can be explained through the total risk position. Total risk increasing justifies more delivery; total risk decreasing justifies less delivery.

C.44 Parts (b) allow the licensee to provide justification in terms of efficient use of resources. For example, among other reasons, this could be related to the smoothing of work programmes to better utilise staff or it could be related to availability of network outages either advancing or delaying work programmes.

C.45 Section 3.6 of the NOMs Incentive Methodology suggests the types of information and justification evidence that could be provided.

C.46 The justification should be provided in a form appropriate to meet the Authority's requirements. This may be a report, accompanied by associated analysis files, reference to documents/information submitted previously or another format as appropriate.

C.47 Where relevant, the justification should make reference to the relevant sections of the Performance Report, to assist the Authority with analysis of the justification.

C.48 The justification should be submitted by 31 January 2024, or later date as determined by any delays to the Authority's notice in stage 4.

Stage 6 – The Authority assesses justification evidence

C.49 The Authority will carry out quantitative and/or qualitative analysis to determine the proportion of over-delivery against NASD targets or proportion of under-delivery against NASD targets that is justified.

C.50 In doing so the Authority will consider the following sources of data:

- RIGs Annex D Secondary Deliverables data templates;
- RIGs Annex B Cost and Volumes data templates;
- Licensee's Performance Report;
- Licensee's Justification Report;
- Licensee's Mid Period Report;
- Other relevant information related to external drivers that have impacted NASD delivery;
- Other relevant data sources.

C.51 Section 3.7 (a) of the NOMs Incentive Methodology describes the scope of the qualitative assessment.

C.52 Section 3.7 (b) of the NOMs Incentive Methodology describes the steps that the Authority will take for quantitative assessment.

C.53 Where the Authority determines that part of an over delivery is unjustified the valuation of over delivery will reflect the element that is justified.

C.54 Where the Authority determines that part of an under delivery is justified the valuation of under delivery will reflect the element that is unjustified.

Stage 7 – The Authority determines the value of the adjustments required

C.55 The NOMs Incentive Methodology specifies the approaches that will be used to value over/under delivery.

C.56 For under-delivery, the values will be based on the ED1 allowed efficient costs.

C.57 For over-delivery, the values will be based on Ofgem's view of efficient costs. The Decision on the Network Output Measures (NOMs) Incentive Methodology dated 6 December 2018, stated that the Authority would use the lower of the licensee's incurred cost and allowed unit cost. Where a unit cost does not exist, the incurred costs will be subject to a high-level efficiency review.

C.58 The NASD monetised risk target represents a combined impact from all the asset categories included within the target. The licensee has been provided with allowances that represent an ex-ante efficient cost for the delivery of the target. This allowance is derived from different unit costs for each asset category. For simplification and to avoid perverse valuation outcomes, the unit costs used for valuation of overall delivery represent an overall unit cost derived from the total expenditure relating to NASD and the associated monetised risk points. This gives a £ per risk point incentive rate (as illustrated in Appendix 3 of the NOMs Incentive Methodology).

C.59 The valuation of over/under-delivery of NASD is determined by the application of a £ per risk point incentive rate to the magnitude of justified over delivery or unjustified under delivery.

C.60 If, in assessing whether the licensee has delivered against the NASD monetised risk target, the Authority identifies a proportion that is due to High Value Projects (HVP), this proportion will be valued using the same methodology as the overall over/under-delivery assessment. The HVP proportion value will be identified separately, to be used in determining the value of the adjustment described in paragraph D.20.

Derivation of incentive rate for under-delivery

C.61 The £ per risk point for unjustified under-delivery is derived from the ED1 NASD Opening Allowances and the total NASD monetised risk target.

C.62 The ED1 NASD Opening Allowances were not clearly stated at ED1 Final Determination so these values have been determined by considering the following:

- Licensee submitted Business Plan costs for NOMs-related activities;
- Licensee submitted RPEs;
- The Authority's view of costs at ED1 Final Determination;
- Regional labour scaling factors used in cost benchmarking at ED1 Final Determination;
- Smart grid cost reductions applied at ED1 Final Determination;
- The Authority's view of RPEs at ED1 Final Determination;
- Interpolation used at ED1 Final Determination;
- The appropriate costs to use where non like-for-like replacement activity has been carried out, noting that costs in Business Plans were stated against the assets being installed, whilst the majority of risk points are based on the assets being removed; and
- The elements of refurbishment activities included by licensees in their NASD monetised risk targets.

C.63 This results in the following ED1 NASD Opening Allowances for ED licensees:

Licensee	ED1 NASD Opening Allowance
ENWL	(to be determined)
NPGN	(to be determined)
NPGY	(to be determined)
WMID	(to be determined)
EMID	(to be determined)
SWALES	(to be determined)
SWEST	(to be determined)
LPN	(to be determined)
SPN	(to be determined)
EPN	(to be determined)
SPD	(to be determined)
SPMW	(to be determined)
SSEH	(to be determined)
SSES	(to be determined)

Example incentive rate calculation (for valuation of under-delivery)

C.64 The table below shows an example of the derivation of the £ per risk point incentive rate for under-delivery derived from the Total ED1 NASD Opening Allowance and Total NASD monetised risk point target.

Description	Label	Value
Total ED1 NASD Opening Allowance	(a)	£200,000,000
Total NASD monetised risk points target	(b)	10,000,000
Allowed £ per risk point	(a)/(b)	£20.00

C.65 Applying this incentive rate to the risk points representing unjustified under-delivery gives the total value of under-delivery.

Derivation of incentive rate for over-delivery

C.66 The £ per risk point for justified over-delivery is derived from the lower of the revealed £ per risk point incentive rate or the allowed £ per risk point incentive rate.

C.67 The licensees revealed £ per risk point incentive rate is derived from the licensee's total incurred costs for NASD related investment during the ED1 price control period (ED1 NASD Actual Expenditure) and the total delivered NASD monetised risk points.

C.68 In deriving the ED1 NASD Actual Expenditure the Authority will consider the appropriate costs to use where there is non like-for-like replacement activity carried out, noting that reported costs in RIGs Annex B Costs and Volumes are against the assets being installed, whilst the majority of risk points are based upon the assets being removed.

Example incentive rate calculation (for valuation of over-delivery)

Description	Label	Value
Total ED1 NASD Actual Expenditure	(a)	£196,000,000
Total NASD monetised risk points delivered	(b)	12,000,000
Revealed £ per risk point	(c)=(a)/(b)	£16.33
Total ED1 NASD Opening Allowance	(d)	£200,000,000
Total NASD monetised risk points target	(e)	10,000,000
Allowed £ per risk point	(f)=(d)/(e)	£20.00
Lower of revealed £ per risk point or allowed £ per risk point	Lower of (c) or (f)	£16.33

C.69 Applying this incentive rate to the risk points representing justified over-delivery gives the total value of over-delivery.

Valuation of justified over delivery and unjustified under delivery

C.70 The valuation of delivery needs to consider the materiality thresholds (deadband) around the NASD monetised risk targets. Section 1.5.2 of the NOMs incentive methodology specifies that the valuation relates to the quantum that falls outside the thresholds.

C.71 Furthermore CRC 5D.9 refers to making adjustments for under-delivery that is not justified and CRC 5D.11 refers to making adjustments for over-delivery that is justified.

C.72 CRC 5D.15 states that no adjustments are made for justified under-delivery and unjustified over-delivery.

C.73 The valuation of under-delivery relies upon:

- An under-delivery of monetised risk;
- The under-delivery being unjustified; and
- The level of unjustified under-delivery exceeding the under-delivery deadband threshold.

C.74 The valuation of under-delivery is determined from the product of the under-delivery incentive rate and the amount of unjustified monetised risk outside the under-delivery deadband threshold.

C.75 The valuation of over-delivery relies upon:

- An over-delivery of monetised risk;
- The over-delivery being justified; and
- The level of justified over-delivery exceeding the over-delivery deadband.

C.76 The valuation of over-delivery is determined from the product of the over-delivery incentive rate and the amount of justified monetised risk outside the over-delivery deadband threshold.

C.77 The valuation of under-delivery/over-delivery represents the ED1 NASD Allowance Adjustment Value that is used within the financial methodology calculations.

Example valuation calculation (under-delivery)

C.78 The following example shows how the incentive rate is applied, incorporating the use of a 5% deadband, to determine the valuation of unjustified under-delivery.

C.79 The example assumes that the NASD monetised risk point target is 10,000,000 and the delivered monetised risk is 8,000,000, resulting in an under-delivery of -2,000,000.

C.80 Based upon the evidence and justification provided by the licensee, the Authority assesses that a proportion of the under-delivery is justified. The proportion that is justified is treated as a credit to the delivered monetised risk points, so that the remaining valuation only acts on unjustified under-delivery. Assuming that the proportion of under-delivery that is justified is 400,000 monetised risk points the resultant justified risk points delivery is 8,400,000 (i.e. the delivered 8,000,000 and the justified under-delivery of 400,000). This leads to an unjustified under-delivery of -1,600,000.

C.81 The resultant justified risk points (8,400,000) is compared to the lower deadband threshold (9,500,000) resulting in an unjustified under-delivery (-1,100,000) outside the deadband threshold.

C.82 The under-delivery incentive rate is applied to the unjustified under-delivery giving the valuation (-£22,000,000) which is the value to be used as the ED1 NASD Allowance Adjustment Value.

Valuation of unjustified under-delivery		
Description	**Label**	**Value**
Monetised risk target	(a)	10,000,000
Lower deadband	(b) = 95% of (a)	9,500,000
Delivered monetised risk points	(c)	8,000,000
Justified under-delivery risk points	(d)	400,000
Resultant justified risk points	(e)=(c)+(d)	8,400,000
Risk points below deadband threshold	(f)=(e)-(b)	-1,100,000
£ per risk point	(g)	£20
Valuation of unjustified under-delivery	(h) = (f)*(g)	-£22,000,000

Example valuation calculation (over-delivery)

C.83 The following example shows how the incentive rate is applied, incorporating the use of a 5% deadband, to determine the valuation of justified over-delivery.

C.84 The example assumes that the NASD monetised risk point target is 10,000,000 and the delivered monetised risk is 12,000,000.

C.85 The assessment of the over-delivery determines that a proportion is unjustified leading to a 500,000 point reduction, giving a resultant justified risk points of 11,500,000.

C.86 The resultant risk points delivered (11,500,000) is compared to the upper deadband threshold (10,500,000) resulting in a justified over-delivery (1,000,000) outside the deadband threshold.

C.87 The over-delivery incentive rate is applied to the justified over-delivery giving the valuation (£16,333,333) which is the value to be used as the ED1 NASD Allowance Adjustment Value.

Valuation of justified over-delivery		
Description	**Label**	**Value**
Monetised risk point target	(a)	10,000,000
Upper deadband	(b) = 105% of (a)	10,500,000
Delivered monetised risk points	(c)	12,000,000
Unjustified over-delivery risk points	(d)	500,000
Resultant justified risk points	(e)=(c)-(d)	11,500,000
Risk points above deadband threshold	(f)=(e)-(b)	1,000,000
£ per risk point	(g)	£16.33
Valuation of justified over-delivery	(h) = (f)*(g)	£16,333,333

Derivation of Reward/Penalty

C.88 CRC 5D specifies that justified over-delivery will be subject to an additional 2.5% reward and unjustified under-delivery will be subject to a 2.5% penalty.

C.89 The example in Appendix 3 of the NOMs Incentive Methodology shows that the reward/penalty value will be determined from 2.5% of the valuation of justified over-delivery or unjustified under-delivery (ie the ED1 NASD Allowance Adjustment Value).

C.90 As an example the penalty associated with the ED1 NASD Allowance Adjustment Value of -£22,000,000 would be 2.5/100*-£22,000,000 = -£550,000

Annex D: ED1 High Value Projects (HVP) Closeout Methodology

Overview

D.1 This HVP Closeout Methodology sets out how the Authority will assess HVP costs to determine the HVP Efficient Qualifying Expenditure for the licensee.

D.2 The Authority will carry out the steps detailed below to determine the licensee's HVP Efficient Qualifying Expenditure.

Step 1: Initial High Level Analysis

D.3 The Authority will carry out an Initial High Level Analysis of the licensee's total opening level of allowed expenditure defined as High Value Project Costs, as set out in Appendix 1 of CRC 3F plus any additional allowed expenditure determined under previous reopeners under CRC 3F (TUCHVPov), relating to RIIO-ED1 HVPs, to determine the requirements of the licensee's Performance Assessment Submission (PAS) (see Annex E) using information submitted by the licensee.

D.4 The Authority will provide the licensee with guidance on the additional information to be submitted in its PAS in line with the timings specified in paragraph X.22 of Chapter X.

D.5 Where an Initial High Level Analysis indicates that the licensee's TUCHVPov is zero and that no expenditure has been incurred on any project meeting the definition of High Value Project Costs set out in CRC 1B, the licensee will not be required to submit a Performance Assessment Submission and there will be no re-opener adjustment for the licensee.

D.6 Where an Initial High Level Analysis indicates that the licensee's TUCHVPov is greater than zero or expenditure has been incurred on any project meeting the definition of High Value Project Costs set out in CRC 1B, the Authority will commence a detailed Performance Assessment as outlined in Step 2 to Step 5 below to determine the HVP Efficient Qualifying Expenditure for the licensee. This will be used in the calculation of a HVP Re-opener adjustment as specified in paragraph X.25 of Chapter X. The Authority may also request additional information in line with Annex E.

Step 2: Determine HVP Efficient Actual Expenditure

D.7 The Authority will carry out an assessment of the efficiency of the licensee's HVP Actual Incurred Expenditure to determine the HVP Efficient Actual Expenditure. In undertaking this assessment, the Authority will interpret efficiency to mean investment decision making by the licensee:

- That took into account all relevant information that could reasonably have been expected to be available to the licensee when making the decision; and,
- That resulted in expenditure on HVPs during the RIIO-ED1 period that would reasonably, at the time of making the investment decision, be required to meet the changing and uncertain needs and requirements of the licensee's electricity distribution system.

D.8 The licensee's HVP Efficient Actual Expenditure will be equal to the licensee's HVP Actual Incurred Expenditure, unless the Authority determines, as a result of the efficiency assessment, that a proportion of the licensee's HVP Actual Incurred Expenditure was not efficient.

D.9 Where the Authority has identified that a proportion of the licensee's HVP Actual Incurred Expenditure was not efficient, it will deduct its value from the licensee's HVP Actual Incurred Expenditure to obtain the HVP Efficient Actual Expenditure for the licensee.

D.10 In deciding whether a proportion of the licensee's HVP Actual Incurred Expenditure was not efficient, the Authority will take into account:

- The extent to which the justification that is provided by the licensee for its HVP Actual Incurred Expenditure is consistent with the definition of efficiency as provided in paragraph D.7; and,
- The quality of supporting evidence provided by the licensee to justify its HVP Actual Incurred Expenditure, based on the information available to it at the time of the investment decision.

D.11 The Authority will have regard to the following principles in carrying out its assessment of the licensee's HVP Actual Incurred Expenditure:

- The Authority will not propose any adjustments relating to unit costs; and,
- The Authority will only base its assessment of the efficiency of the licensee's HVP in the context of the information that the licensee had available, or should reasonably have had available, at the time of making its investment decisions.

D.12 The evidence and analysis that the Authority will take into account in its assessment of the efficiency of the licensee's HVP Actual Incurred Expenditure will include, but not be limited to, the following:

- Evidence that the licensee had appropriate decision making processes and procedures in place and that these were applied by the licensee to decisions relating to its HVP Actual Incurred Expenditure;
- Evidence of the technical and (where appropriate) economic need case for the investment and expenditure being incurred, or any relevant obligations;
- Information on the drivers of HVP expenditure at the time the expenditure decision was made; and,
- Where appropriate, consideration of alternative options for delivering the outputs/work required.

Step 3: Adjustment for delayed or deferred projects

D.13 The Authority may make an adjustment to the licensee's HVP Efficient Actual Expenditure obtained at Step 2 to account for projects delayed or deferred into another price control period.

D.14 In deciding whether or not to make an adjustment under paragraph D.13, the Authority will consider:

i. The cost of the project as a whole, including whether equivalent or ongoing works have or have not been funded as part of the licensee's RIIO-ED2 settlement;

ii. Evidence that the licensee had appropriate decision making process and procedures in place, and that these were applied by the licensee to the decision to delay or defer a project; and,

iii. Whether a HVP Network Outputs Gap has arisen in relation to an individual RIIO-ED1 HVP which has been delayed or deferred following an assessment under Annex C.

D.15 Where the Authority decides to make an adjustment under paragraph D.13, the Authority will add an adjustment for delay or deferral to the HVP Efficient Actual Expenditure based on its analysis carried out under paragraph D.14.

Step 4: Determine HVP Efficient Re-opener Expenditure

D.16 The HVP Efficient Re-opener Expenditure for the licensee will be equal to the HVP Efficient Actual Expenditure, adjusted at Step 3 where relevant, unless the licensee can provide evidence of efficiencies achieved through Innovative Solutions in the method and scope of work that was undertaken to address an identified need during RIIO-ED1 and which resulted in Avoided HVP Expenditure.

D.17 The licensee may provide evidence of efficiencies achieved through Innovative Solutions as well as its own view of the HVP Efficient Re-opener Expenditure as part of its PAS, and the Authority will consider whether the licensee has implemented these Innovative Solutions.

D.18 The evidence the Authority will take into account in performing its assessment of any efficiencies achieved through the use of Innovative Solutions will include, but not be limited to:

- Cost-benefit or other financial analysis submitted by the licensee demonstrating the saving resulting from the solution adopted by the licensee compared to alternative solutions (including conventional solutions), including information explaining and justifying any assumptions that have been made; and,
- evidence provided by the licensee that the solution deployed meets the criteria defined as Innovative Solutions in the latest version of Annex A of the RIGs, when addressing a need for HVP expenditure.

D.19 The Authority will determine whether to accept or reject the evidence provided by the licensee under paragraph D.17 of efficiencies achieved through Innovative Solutions. Where the Authority rejects the evidence provided by the licensee, the HVP Efficient Re-opener Expenditure for the licensee will be equal to the HVP Efficient Actual Expenditure, adjusted where appropriate under Step 3, for the licensee.

D.20 Where the licensee can provide such evidence, to determine the HVP Efficient Re-opener Expenditure, the Authority will apply an efficiency adjustment to the HVP Efficient Actual Expenditure, as adjusted where appropriate under Step 3, which is calculated as the difference between:

- The Authority's assessment of expenditure the licensee would have incurred in the absence of Innovative Solutions, where possible referencing the licensee's "E6 – Innovative Solutions" submissions as described in Annex J of the RIGs; less
- The costs that were incurred by the licensee in delivering the Innovative Solution, where possible referencing the licensee's "E6 – Innovative Solutions" submissions as described in Annex J of the RIGs.

D.21 Where, having carried out the assessment under Annex C of the licensee's performance against Network Asset Secondary Deliverables (NASD) targets over the ED1 period, the Authority identifies and quantifies a proportion of the output gap due to

HVPs, the value of this proportion will be netted off the adjustment described in paragraph D.20.

Step 5: Determine HVP Efficient Qualifying Expenditure

D.22 To give effect to this adjustment, the Authority will determine the proportion of the HVP Efficient Re-opener Expenditure values for the licensee that should be attributed to each year of the Price Control Period, for the purpose of that calculation, having regard to the timing profile of the licensee's Aggregate Baseline Expenditure Allowances, and the split between load related and non-load related RIIO-ED1 HVPs.

D.23 For the purposes of the adjustment described in paragraph D.20, load related RIIO-ED1 HVPs are projects with one or more of the following primary investment drivers:

- General reinforcement; or
- Fault level reinforcement,

And non-load related RIIO-ED1 HVPs are projects with a primary driver such as:

- Asset replacement;
- Legal and safety; or
- BT21CN.

Annex E: General Financial Adjustment Methodology

E.1 Where the Authority makes a determination for any of the relevant values specified in Table 1, that determination will specify the years to which the determination applies, according to the relevant licence condition(s). The Authority will undertake the following steps to calculate these values:

i. Calculate the value of the adjustment to the relevant value, as specified in Table E1, where a positive value specifies an increase, and a negative value specifies a reduction, ensuring the value of this adjustment meets the requirements of the relevant licence reference, as specified in Table 1. For UCSEFEC, UCSEBC, and UCSESPC, the adjustment will be the sum of the adjustments determined for each year of the ED1 Price Control Period.

ii. Restate the value calculated at (i) from 2012/13 prices to the price base for the ED2 Price Control Period, using a calculation that (in the context of the ED2 Price Control Period financial methodologies) ensures that RPI inflation is recognised up to and including the end of the ED1 Price Control Period.

iii. Apportion the value calculated at (ii) to the relevant Regulatory Years of the ED1 Price Control Period, in proportion to the timing profile of the licensee's Relevant Value from Table D1 below. For UCSEFEC, UCSEBC, and UCSESPC, the value calculated at (ii) will be apportioned in line with the timing profile of adjustments set out in the determination.

iv. Multiply the values calculated at (iii) by the licensee's Totex Incentive Strength Rate, as set out in Appendix 1 to CRC 3B of the licence.

v. Calculate the total value of the financial adjustment, as at the first year of the ED2 Price Control Period, by:

(a) applying the relevant Time Value of Money Adjustment to each of the values calculated at (iv) to reflect deferral to 2023/24; and

(b) taking the sum of the resulting values.

vi. Calculate the part of the financial adjustment calculated at (v) that is to be given effect through regulatory asset value (RAV), by reference to the principle that the licensee's opening RAV balance for the ED2 Price Control Period should be set at the level that would have occurred had the licensee's Relevant Value from Table D1 been subject to the adjustments calculated at (iii) within the ED1 Price Control Period. This principle will have been met for the purpose of these financial methodologies if the calculation:

(a) Multiplies the annual values calculated at (iv) by the licensee's Capitalisation Rate, as set out for the licensee in Appendix 1 to CRC 3B of the licence; and

(b) Subtracts from the values calculated at (vi).a the amount of depreciation that would have occurred in the Price Control Period and reflecting the asset life applied for each relevant year; and

(c) takes the sum of the resulting values.

vii. Subtract the value calculated at (vi), with any necessary Time Value of Money Adjustment to place this on a consistent 2023/24 basis, from the total value of the financial adjustment calculated at (v) to calculate the adjustment that is to be made directly to ED2 Price Control Period Base Demand Revenue, and spread this value evenly across the years of the ED2 Price Control Period.

viii. Subtract from the value calculated in (vi), and the values calculated at (vii), any provisional amounts for these values included in the calculation of ED2 Opening Base Revenue Allowances and opening RAV.

ix. Use the values calculated at (viii) as revisions to the ED2 Price Control Period opening RAV balance and ED2 Base Demand Revenue for each relevant year in any determination under the relevant licence reference from Table D1 below recognising in that determination that:

(a) the relevant values will flow into the calculation of corporation tax allowances (or, if this will not be the case, applying a corporation tax adjustment to the values stated in the determination to increase their value on account of the subsequent application of corporation tax, as this methodology calculates the adjustment value on a post-tax basis); and

(b) Time Value of Money Adjustment will be applied within the ED2 Price Control Period to each relevant value to reflect any deferral from 2023/24 (or including a provisional value in the determination associated with these Time Value of Money Adjustments) and stating that any subsequent calculations will be applied or updated once the necessary values are known.

Table E1

Close out methodology	**Relevant values**	**Relevant licence reference**
Load related expenditure	TLRRCF values	CRC 3G.20
Net to gross adjustment	TLRRCF values	CRC 5G.14
Network asset secondary deliverables	The Licensee’s total NOMs-related expenditure	CRC 5D.9 or CRC 5D.11
High value projects	High Value Project Costs	[licence condition still to be written and consulted upon]
Shetland	UCSEFEC, UCSEBC and UCSESPC values, as appropriate	CRC 3F.26
Link Boxes	UCLB values	[licence condition still to be written and consulted upon]

Annex F: Performance Assessment Submission

Overview

F.1 In order for the Authority to undertake its Performance Assessment for the closeout of RIIO-ED1, the licensee is required to submit supporting information in the form of a Performance Assessment Submission (PAS).

F.2 The information that the licensee may be required to provide as part of the PAS with respect to each of the Load Related Expenditure (LRE), Network Asset Secondary Deliverables (NASDs), High Value Projects (HVP), and Link Box Costs is set out in this annex.

F.3 The Authority will only request information in the PAS where it identifies gaps in its existing information, or where specific questions have arisen as a result of its Initial High Level Analysis. The information requested by the Authority will be proportionate to the results of the Initial High Level Analysis and will include any outstanding information required to address issues identified.

F.4 Following the Initial High Level Analysis, the Authority will inform the licensee of any specific information required to be submitted in its PAS, in relation to LRE, NASDs, HVPs, and Link Boxes. The information will be requested in accordance with the paragraph numbering outlined in this annex.

F.5 In submitting information the licensee may be required to set out how it has ensured the robustness of its data.

1 Load Related Expenditure

F.6 The extent of narrative and supporting evidence provided to the Authority should be proportionate to the degree to which the Authority's Initial High Level analysis shows the licensee's TLRRCF to be higher or lower than the relevant materiality thresholds for the re-opener.

F.7 The Performance Assessment Submission should explain any data quality issues over the Price Control Period which have affected Load Related Expenditure.

F.8 Any explanations of changes to activities should be given relative to the activities that were detailed in the licensee's business plan.

F.9 For a sample of investment schemes where expenditure was incurred in the 'primary', 'fault level' and 'NTCC' categories, the Authority may require the licensee to provide a description of the technical aspects of the scheme including:

i. the original technical solution;

ii. any changes to the technical solution along with an explanation of the reason for changing the solution;

iii. where relevant, information on Load Indices or utilisation relevant to the scheme;

iv. any relevant financial or cost benefit analysis, or analysis of options, undertaken by the licensee at the time decisions on expenditure were made by the licensee.

Connections within the price control

F.10 To inform the Authority's analysis of Load Related Expenditure associated with connections, the Authority may require the licensee to include in its Performance Assessment Submission:

i. an explanation of changes in the volume and mix of connection schemes;

ii. information on any trade-off / relationship with General Reinforcement; and

iii. information on changes to the number of connections carried out by independent connection providers, compared to those anticipated in the licensee's ED1 allowances, where the licensee was required to carry out associated non-contestable work.

General Reinforcement - primary

F.11 To inform the Authority's analysis of primary General Reinforcement (including n-2 reinforcement), the Authority may require the licensee to include in its Performance Assessment Submission:

i. an overview of Primary General Reinforcement expenditure carried out during the ED1 Price Control Period.

ii. information on load indices and utilisation.

iii. for schemes that were delayed, deferred or where a new requirement arose, an explanation of why these changes occurred. This will include where Primary General Reinforcement was impacted by changes to connections activity.

iv. for schemes that went ahead, an explanation of the licensee's decision making process in incurring the expenditure.

General Reinforcement - secondary reinforcement

F.12 To inform the Authority's analysis of General reinforcement – secondary reinforcement, the Authority may require the licensee to provide in its Performance Assessment submission:

i. a narrative of its secondary reinforcement expenditure in the Price Control period, with reference to its allowed expenditure for secondary reinforcement in the Price Control Period, that should include reference to the drivers that led to the need for the expenditure on secondary reinforcement schemes or changes in expenditure compared to the ED1 allowances (including any changes in the volume of electric vehicles, distributed generation or electric heating or heat pump systems when compared to those compared to those included in the licensee's RIIO-ED1 Business Plan).

ii. internal documentation and associated narrative to inform the Authority of the licensee's decision making processes for secondary reinforcement.

Fault Level Reinforcement

F.13 To inform the Authority's analysis of Fault Level Reinforcement, the Authority may require the licensee to include in its Performance Assessment Submission a narrative of its Fault Level reinforcement expenditure for the Price Control Period:

i. made with reference to allowed expenditure for Fault Level reinforcement in the Price Control Period; and

ii. including reference to the drivers that led to the need for the expenditure on Fault Level reinforcement schemes or changes in expenditure compared to the Price Control Period allowances.

New Transmission Capacity Charges (NTCC)

F.14 To inform the Authority's analysis of new or reinforced Transmission Connection Points, the Authority may require the licensee to include in its Performance Assessment Submission a narrative of expenditure during the ED1 Price Control Period, which should:

i. be made with reference to the allowed expenditure for NTCC in the ED1 Price Control Period; and

ii. include reference to the drivers that led to the need for the expenditure on NTCC schemes or changes in expenditure compared to the RIIO-ED1 baselines.

Avoided Reinforcement Expenditure

F.15 For Avoided Reinforcement Expenditure to qualify under Step 4 of the procedure set out at Annex A (the ED1 Load Related Re-opener Closeout Methodology), the licensee must demonstrate how it achieved efficiencies in its expenditure due to innovations in the method and scope of work which was undertaken during the Price Control Period.

F.16 To inform the Authority's analysis under paragraph A.13 of Annex A, the Authority may require the licensee to include in its Performance Assessment Submission:

i. an explanation of the Innovative Solutions adopted to address, avoid or defer reinforcement, including its cost and evidence that the solutions differed from other conventional solutions that were in widespread use by the licensee or other licensees at the beginning of the Price Control Period;

ii. a justification of the need for the reinforcement which the Innovative Solutions are addressed, avoided or deferred, and the licensee's best estimate of the cost of a conventional reinforcement solution;

iii. a demonstration that the Innovative Solutions were in the interests of Customers along with details of alternative solutions considered by the licensee;

iv. a demonstration that the innovation avoided costs meet the criteria set out in the latest version of Annex A of the RIGs (or, to the extent the costs did not, any evidence the licensee can provide on why the innovation should be recognised);

v. financial or cost benefit analysis to demonstrate the Innovative Solutions delivered (or are continuing to deliver) benefits to customers

vi. any other relevant evidence from (or in relation to) the licensee's decision-making process.

2 Network Asset Secondary Deliverables

F.17 This section provides guidance on the contents of Performance Reports required by stage 1 and 2 of the Network Asset Secondary Deliverables Close out methodology and Justification Reports required by stage 5 of the Network Asset Secondary Deliverables Close out methodology.

F.18 This guidance should be used alongside the guidance provided in Appendix 1 of the NOMs Incentive Methodology, which specifies the types of information required for the Performance Report.

Performance against target

F.19 The licensee should specify its view of performance against the NASD monetised risk target. This should draw upon/make reference to data submitted within RIGs Annex D data templates and Network Asset Workbooks/Monetised Risk Workbooks.

F.20 As a minimum the licensee should provide a view of the total delivered monetised risk as compared against the total NASD monetised risk target.

F.21 The licensee may provide further disaggregation of performance to illustrate how the components of the performance vary to the components of the targets. The level of granularity is at the discretion of the licensee and should be proportionate to the amount of variation to the NASD monetised risk target (e.g. a licensee with a large variance to target would be expected to provide more detail).

Relevant risk changes and impact on performance against targets

F.22 As specified in section 3.2 of the NOMs Incentive Methodology, Non-NOMs (NASD) intervention risk changes and Non-intervention risk changes can affect the scale of activity that is carried out and affect the delivery of NASD monetised risk targets. For example:

- If deterioration is greater than expected, there may be a higher number of poor condition assets available to be replaced, which may lead the licensee to decide to address more of this type of asset;
- Conversely, if deterioration is less than expected, there may be fewer poor condition assets, which might lead the licensee to address fewer assets, or to risk trade with the asset categories where more risk reduction opportunity exists;
- If assets are impacted through non-NOMs (NASD) interventions (such as reinforcement) there may be less opportunity to deliver risk reduction via asset replacement or refurbishment. Therefore the licensee may address fewer of this type of asset under NOMs (NASD) interventions and may choose to trade with the asset categories where more risk reduction opportunity exists.

F.23 The scope and materiality of the details of relevant risk changes is at the discretion of the licensee. Where the licensee elects to provide details of relevant risk changes these should be provided as part of the Performance Report.

F.24 The information provided should be a summary of the impact of relevant risk changes supported by analysis that illustrates how Non-NOMs (NASD) intervention risk changes and/or Non-intervention risk changes have impacted the delivery of NASD targets.

F.25 The licensee is not required to describe all risk changes. This analysis is only required where it has a significant impact upon the delivery of NASD targets. Limiting this analysis reduces the burden of evidence required to be produced by the licensee and the amount of review required by the Authority.

F.26 It is anticipated that such analysis will need to be carried out at asset category level to illustrate the specific issues with specific health index asset categories.

Provision of initial justification in the Performance Report

F.27 CRC 5D requires that justification of performance is provided as part of the Performance Report submitted by 31 July 2023. The NOMs Incentive Methodology recognises that justification can be provided as part of the Performance Report and provides guidance on the types of data and analysis in Appendix 1 of the NOMs Incentive Methodology.

F.28 Where relevant, the licensee should provide:

i. an explanation of the drivers of the licensee's NASD Interventions and the supporting rationale for those Interventions undertaken in the ED1 period.

ii. an explanation of trade-offs between HI Asset Category Interventions i.e. how the licensee has reprioritised work across HI Asset Categories and justify why the reprioritisation was appropriate;

iii. an explanation of trade-offs between asset replacement and refurbishment work and why, in the licensee's view, this trade-off was appropriate.

F.29 Taking into account all this information, the licensee's Performance Report should set out and justify the licensee's view as to whether the NASD interventions delivered by the licensee represent an efficient outcome for customers, having regard to the information available to the licensee and the circumstances prevailing at the time the licensee made its asset management decisions.

Provision of additional Justification Report

F.30 Where the Authority determines that a licensee has delivered monetised risk outside the materiality threshold (deadband) around the NASD monetised risk target, the licensee is required to submit a Justification Report in accordance with Stage 5 of the NOMs Incentive Methodology.

F.31 For Electricity Distribution, CRC 5D requires that initial justification of performance is provided as part of the Performance Report submitted by 31 July 2023.

F.32 The Justification Report supplements the justification already provided and the contents will be guided by any observations the Authority has made during its assessment of performance.

F.33 Appendix 1 of the NOMs Incentive Methodology provides guidance on the types of data and analysis that can be used within the Justification Report.

3 High Value Projects

F.34 The licensee may be required to provide an overview of each individual RIIO-ED1 HVP that was carried out in RIIO-ED1. This should include a supporting narrative and variance analysis of the licensee's actual expenditure relative to RIIO-ED1 allowance.

F.35 The licensee's Performance Assessment Submission may be required to include summary information on:

i. the HVPs that the licensee has completed during the RIIO-ED1 period;

ii. the HVPs that the licensee deferred or delayed into later price controls or cancelled during the RIIO-ED1 period;

iii. the HVPs that the licensee has started during the RIIO-ED1 period, but will not complete until the RIIO-ED2 period; and,

iv. the licensee's investment decision-making processes relating to RIIO-ED1 HVPs.

HVP Actual Incurred expenditure

F.36 The licensee may be required to provide information to support the technical, regulatory and economic need for its RIIO-ED1 HVP Actual Incurred Expenditure. This may include, but is not limited to, the following:

i. a statement of the original needs case for individual RIIO-ED1 HVPs and whether the needs case changed (where applicable);

ii. analysis or data to support the need for each individual RIIO-ED1 HVP including information on the drivers of the expenditure at the time the investment decision was made;

iii. relevant financial or cost benefit analysis, undertaken by the licensee at the time decisions on RIIO-ED1 HVP expenditure were made by the licensee;

iv. analysis of options and alternative investment solutions considered; and,

v. arrangements for management and delivery of RIIO-ED1 HVPs.

Avoided HVP Expenditure

F.37 For Avoided HVP Expenditure to qualify under Step 4 of the HVP Re-opener Assessment Methodology, it will be the responsibility of the licensee to demonstrate how it has achieved efficiencies in HVP expenditure which are due to innovations in the method and scope of work which was undertaken during the RIIO-ED1 period.

F.38 The Authority may require the licensee to provide:

i. an explanation of the Innovative Solutions adopted to address, avoid or defer HVP expenditure (where applicable);

ii. justification of the need for the investment which the Innovative Solutions are meeting; and,

iii. demonstration that the Innovative Solutions are in the interests of consumers and details of alternative solutions.

F.39 Where required to provide information on Avoided HVP Expenditure, the licensee should use financial or cost benefit analysis to demonstrate the Innovative Solutions deliver benefits to customers and present evidence of the decision process. This should include evidence that the proposed Innovative Solutions differs from other conventional solutions that were in widespread use at the beginning of RIIO-ED1 by the licensee or other licensees when addressing a need for HVP expenditure; and provide an estimate of the licensee's view of the likely cost of alternative investment solution relative to the adopted Innovative Solutions.

HVP Network Outputs Gap

F.40 To inform the Authority's assessment of whether or not a HVP Network Outputs Gap has arisen and the quantification of the HVP Network Outputs Gap, the licensee may be required to provide the following information in its Performance Assessment Submission:

i. a description of the Agreed RIIO-ED1 Network Outputs for each individual RIIO-ED1 HVP; and,

ii. a variance analysis of the type and volume of HVP assets that were forecast to be delivered by the licensee during the RIIO-ED1 period and the type and volume of assets actually delivered by the licensee for each individual RIIO-ED1 HVP.

F.41 The licensee should indicate as part of its Performance Assessment Submission whether it considers it has delivered the Agreed HVP Network Outputs for each individual RIIO-ED1 HVP, and provide supporting narrative and information. This includes but is not limited to:

i. information on Delivered HVP Network Outputs and assessment against Agreed HVP Network Outputs;

ii. where applicable, information and reasoning behind any failure to deliver Agreed HVP Network Outputs; and,

iii. any other relevant information, such as cost benefit analyses, relating to individual RIIO-ED1 HVPs.

F.42 Where the licensee has not delivered Agreed HVP Network Outputs for an individual RIIO-ED1 HVP, the licensee's Performance Assessment Submission must state whether the failure to deliver outputs is due to:

i. there being a change in scope of the project's Agreed HVP Network Outputs;

ii. cancellation of the project;

iii. the project being deferred or delayed partially or in its entirety into RIIO-ED2; or

iv. there being a change in project scope.

F.43 Where there has been a change in the Agreed HVP Network Outputs for an individual project, the licensee should provide in its Performance Assessment Submission:

i. a statement and supporting rationale for whether the licensee considers the Delivered HVP Network Outputs for the project to be equivalent to the Agreed HVP Network Outputs or not;

ii. supporting information on the decision-making processes, technical and financial and/or cost benefit analysis (where applicable) from the time of the project investment decision which supports the reasoning behind the change in project outputs;

iii. analysis of the impact of the changes in outputs on the overall costs and timescales for delivery of the project; and,

iv. an assessment of whether outputs have been delivered and whether the Delivered HVP Network Outputs are in the interest of consumers.

F.44 For projects that were cancelled and did not start during the RIIO-ED1 period, the licensee must submit an explanation of why the project has not gone ahead. The licensee’s Performance Assessment Submission should provide:

i. supporting information on the decision-making processes, technical and financial and/or cost benefit analysis (where applicable) from the time of the project investment decision that supported cancellation of the project; and,

ii. information on the value of the cancelled project and any costs incurred by the licensee in relation to the project including preliminary works carried out by the licensee before the project was cancelled.

F.45 For projects that were started in RIIO-ED1 and have been partially deferred into RIIO-ED2, the licensee must provide in its Performance Assessment Submission:

i. supporting information on the decision-making processes, technical and financial and/or cost benefit analysis (where applicable) that support the need and decision to partially defer the project into RIIO-ED2;

ii. details and reasons behind delays in project start and/or delivery or other rephasing of the work;

iii. an assessment of whether outputs have been delivered in a manner that is deemed to be consistent with the definition of efficiency in paragraph D.7 of Annex C1 and whether the Delivered HVP Network Outputs are in the interest of consumers; and,

iv. an assessment of the difference between the Agreed HVP Network Outputs and the Delivered HVP Network Outputs.

F.46 If the project has been deferred into a later price control period, the licensee may also be required to identify:

i. where there is no additional allowance for the project in RIIO-ED2:

(a) an estimate of the costs that will be spent in RIIO-ED2 to complete the project; and,

(b) a description of outputs which were not delivered during the RIIO-ED1 period and are expected to be delivered during RIIO-ED2 including the timing of this work.

ii. where there is an additional allowance for the project in RIIO-ED2:

(a) a summary of RIIO-ED1 expenditure for the project against the RIIO-ED1 allowance and new RIIO-ED2 allowance for the project;

(b) a revised forecast of actual expenditure in RIIO-ED2; and,

(c) a description of outputs which were not delivered during the RIIO-ED1 period and are expected to be delivered during RIIO-ED2 including the timing of delivery of the outputs.

4 Link Box Costs

F.47 The extent of narrative and supporting evidence provided to the Authority should be proportionate to the degree that the licensee's Actual RIIO-ED1 Link Box Replacement Volumes are higher or lower than the Allowed RIIO-ED1 Link Box Replacement Volumes. This applies to SPN and SPMW only.

F.48 The Performance Assessment Submission should explain any data quality issues over the Price Control Period that have impacted the costs associated with the Actual RIIO-ED1 Link Box Replacement Volumes.

F.49 Any explanation of changes to activities should be given relative to the activities that could reasonably assumed to have been catered for in the Allowed RIIO-ED1 Link Box Replacement Volumes.

Appendix 2 – Privacy notice on consultations

Personal data
The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer
The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data
Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data
As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

3. With whom we will be sharing your personal data
(Include here all organisations outside Ofgem who will be given all or some of the data. There is no need to include organisations that will only receive anonymised data. If different organisations see different set of data then make this clear. Be a specific as possible.)

4. For how long we will keep your personal data, or criteria used to determine the retention period.
Your personal data will be held for ***(be as clear as possible but allow room for changes to programmes or policy. It is acceptable to give a relative time e.g. 'six months after the project is closed')***

5. Your rights
The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at https://ico.org.uk/, or telephone 0303 123 1113.

6. Your personal data will not be sent overseas (Note that this cannot be claimed if using Survey Monkey for the consultation as their servers are in the US. In that case use "the Data you provide directly will be stored by Survey Monkey on their servers in the United States. We have taken all necessary precautions to ensure that your rights in term of data protection will not be compromised by this".

7. Your personal data will not be used for any automated decision making.

8. Your personal data will be stored in a secure government IT system. (If using a third party system such as Survey Monkey to gather the data, you will need to state clearly at which point the data will be moved from there to our internal systems.)

9. More information For more information on how Ofgem processes your data, click on the link to our "Ofgem privacy promise".