

ED1 close-out methodology response

NORTHERN POWERGRID'S KEY POINTS

- The timely nature of Ofgem's proposals to set a close out methodology for ED1, with a consultation well ahead of the end of the ED1 period, is a welcome and significant improvement relative to DPCR5.
- These methodologies should set out the financial aspects of the close out calculation to provide licensees and other stakeholders with certainty.
- In doing so it is critical that they respect the relevant price control decisions and the ED1 licence, as to do otherwise would undermine certainty in the regulatory settlement.
- The ED1 licence already sets the framework for the close out, since there are already licence conditions which detail how the various close out reopeners will be conducted and how their thresholds will be evaluated. It is important that the handbook aligns to these.
 - We have highlighted a number of specific instances (for example, the application of an innovation adjustment in the high value project reopener calculations) where the handbook drafting is misaligned to the licence; the handbook drafting should be corrected.
 - Ofgem is proposing an adjustment to how revenue adjustments are processed in ED2, which would represent a net-present-neutral timing change relative to the licence and so may not be contentious.
 - We have also identified two specific issues with the licence that result in a circular calculation of a key equation. This is mathematically problematical and Ofgem should consider carefully how to address these two instances.
- The proposals correctly depart from the DPCR5 approach in a number of areas where the ED1 licence dictates this. We support this approach, of which good examples are:
 - the fact the ED1 high value projects approach relies on an expenditure reopener (with no outputs reopener); and
 - the fact no real price effect adjustments are proposed as part of the ED1 calculations.
- The proposals fail to provide certainty in respect to the network asset secondary deliverable (NASD), due to the inclusion of a discretionary ability for Ofgem to set a licensee specific deadband for the NASD calculations. This deadband should be set as soon as practicable to avoid undermining the certainty provided by other aspects of the proposals.
- The consultation document may also give the false impression that there is a specific close-out mechanism to recover ED1 funding if there are deficiencies in asset data; the decision should be clear that there is no routine close-out mechanism for this and that financial penalties are unlikely where there has been no wrongdoing.
- Lastly, a change made after the working groups, to define all close out terms with respect to the ED2 licence, creates a risk that adjustments to generic defined terms at ED2 could have unintended consequences (in effect re-opening the close-out rules). If this approach is maintained, Ofgem must take care to mitigate this risk on an ongoing basis, and Ofgem must also extend similar care to the ED2 licence drafting process.

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1. Introduction

1. We have provided our response in two parts:
 - a. A mechanism by mechanism summary of the substantive issues with the proposed drafting.
 - b. Two annexes setting out detailed drafting edits and explanatory comments, including but not limited to these substantive points, covering:
 - i) The main chapter in the financial handbook (annex 1); and
 - ii) The various annexes (A to F) to the financial handbook chapter (annex 2).
2. The first of these starts immediately below, with generic issues that apply across all of the mechanisms.

2. Generic issues across the financial handbook

It is vital that the close out respect the ED1 settlement

3. The electricity distribution licence already sets the key calculations and thresholds for the end of ED1 period close out. The ED1 close-out handbook methodologies should therefore only clarify those financial aspects of the close out calculation that are not already included in the licence, to provide licensees and other stakeholders with certainty on these aspects.
4. In doing so, it is critical that the handbook drafting respects the relevant price control decisions and the ED1 licence, as to do otherwise would undermine certainty in the regulatory settlement. This certainty underpins the low cost of capital that Ofgem has been able to set in various price controls since privatisation, and supports ongoing investment in the electricity distribution sector. Maintaining it is in the interests of consumers.
5. This is not always easy to achieve. The structure of the ED1 settlement, with the ED1 strategy decision taken relatively early and licence modifications somewhat later, led to a number of instances where the Authority revised its initial strategy decision prior to licence modification. There were also areas where the strategy decision may have been unclear, or where the licence modification may indicate implicitly that the decision was revised.¹ In these areas we presume that the consultation position represents Ofgem's considered view of the policy decision encapsulated in the ED1 licence modification.
6. There are also some areas where we believe there may be clear departures from that licence modification, such as the application of an innovation adjustment in relation to the high value

¹ Topics discussed at the working groups include how load indices would be used and also how the end of period high value projects expenditure reopener would operate.

projects re-opener. We have highlighted these areas in our consultation response below. The handbook drafting in these areas should instead be aligned with the licence, to preserve certainty.

7. Lastly, the consultation document may also give the false impression that there is a specific close-out mechanism to recover ED1 funding if there are deficiencies in asset data; the decision should be clear that there is no routine close-out mechanism for this and that the appropriate response to data issues (where there has been no wrongdoing) is unlikely to involve financial penalties.

The financial methodology would benefit from a brief over-arching section that sets out generic points applying to all methodologies

8. It would be appropriate to include a short over-arching introductory section in the main financial handbook chapter. This could gather together a number of important points that apply to all the methodologies in a single place and:
 - a. State that the calculations in the chapter are to be undertaken in 2012/13 prices on the ED1 price control price base;
 - b. State the licence conditions that the financial methodologies relate to, and make clear that the methodologies only relate to adjustments being made after the end of the ED1 period under those conditions (which is currently stated in one of the methodologies, but not the others); and
 - c. Make any overarching clarifications regarding defined terms in one place rather than several (if the standard convention in the financial handbook is not being followed).
9. We have proposed some wording on the first two of these in our detailed drafting comments.
10. On point c, we note that the drafting being consulted on proposes to anchor capitalised terms to the current licence, which is a departure from the working group assumption that many terms would be defined with reference to the ED1 licence at a specific point in time. The change creates two issues:
 - a. a larger number of legacy ED1 terms will need to be defined in the ED2 licence and/or ED2 financial handbook; and
 - b. there is a greater chance of unintended consequences as the ED2 licence and financial handbook are being drafted, e.g. if a future change to a “generic” term used in both ED1 and ED2 affects the close out result.
11. In making this change relative to the working group assumption, Ofgem must take care to ensure these issues are properly mitigated in respect of the financial handbook (as well as in respect of the licence provisions, which should be preserved on the move to ED2).
12. It would also seem sensible adopt the standard defined term convention in the financial handbook, which is to refer to terms defined in the licence or define the terms in the glossary with reference to the licence. Using the standard convention necessitates no explanation and therefore the repeated statements in the methodologies that defined terms relate to the current licence could be deleted.

Adjustments to the ED2 opening RAV balance are a net-present-value neutral change relative to the current licence

13. We can see the policy merit of adjustments to allowances resulting from the ED1 close out being processed in such a way as to place licensees and energy consumers in the same position (or as close to that position as possible) as they would have been had ED1 allowances been set at their final level from the outset. If this principle were not adopted, then energy consumers in the ED2 period could, in effect, end up paying for (or benefitting from) adjustments that would benefit (or be paid for by) future consumers.
14. In contrast, the relevant licence conditions typically refer only to adjustments to "base demand revenues in the [ED2] price control period" and make no referent to adjustments to the "opening RAV balance" or equivalently to "revenues in future price control periods". The proposed financial handbook drafting departs from the licence. As a general rule, such departures should be avoided. In this instance the departure may however be non-contentious, since the difference between the two approaches represents a timing issue only, rather than something which changes the net present value of the price control settlement (when discounted at the allowed cost of capital).

It is appropriate that DPCR5 style RPE adjustments are not being made

15. At the DPCR5 close out, adjustments for real price effects (RPEs) were made, so that licensees carried the risk of RPEs turning out differently to price control assumptions under the load related and high value project expenditure reopeners. Because RPEs turned out lower than forecast, this provision ensured that those licensees retained that outturn benefit.
16. The ED1 strategy decision indicated that this RPE provision was being retained. However, by the time of the licence modification, Ofgem must have decided that it would not be appropriate to retain it, as the licence modifications made no mention of RPEs as a factor that could be taken into account when assessing the reopener. This means that, at ED1, if RPEs turn out lower than assumed in the settlement, licensees triggering the HVP or load related expenditure reopener would not retain that benefit.

Linkages between the various methodologies

17. For the methodologies to operate correctly, and be clear to users, they should ideally follow the same generic structure:
 - a. the methodology in the main handbook should include a clear link back to the licence, and should draw on the detailed annexes for any input calculations; and
 - b. the annexes should give details on how the inputs to the licence and the handbook calculations should be evaluated, to the extent this is not already detailed in the licence.
18. In a number of instances the proposed component parts lack the clear linkages necessary between the licence, the main financial handbook drafting and the various appendices, potentially leaving it unclear how some values will be calculated or used. For example, the high value projects annex is

also presented more as a standalone methodology, with its own defined terms, that makes it difficult to map it to the licence. We have proposed some edits that help to address these points in our detailed comments on the drafting but it may also be appropriate that this point be addressed through an additional working group meeting on this topic.

3. The load related re-opener Methodology

There are issues with the definition of TLRRCF in the licence

19. There are issues with licence definition of a critical value in the reopener calculation: the total level of expenditure that is to be used in evaluating whether or not the reopener is triggered (TLRRCF). There are two definitions which appear to be relevant to this.
 - a. CRC3G.6(a) defines LRRCF to be efficient load related expenditure, which would be a sensible value to compare with the level of allowances and determine whether the 20% plus materiality threshold is met.
 - b. CRC3G.7 defines TLRRCF to be the proposed revised level of allowances. This term is then used in CRC3G.7 (in the evaluation of whether the re-opener thresholds are met) and in CRC3G.10 (in calculating the limits on the proposed size of the adjustment to allowances).
20. With TLRRCF defined as it is at CRC3G.7, there appears to be a circularity between its definition (the proposed revised level of allowances) and its use in the calculation of the proposed revised level of allowances (in CRC3G.10). This would be mathematically problematical and could result in an undefined value in a key reopener equation. Moreover, with TLRRCF defined as it is, the reopener 20% of expenditure threshold would also be applied at least twice as part of CRC3G.7 (first in calculating the proposed revised level of allowances and second in testing for the material amount).
21. Ofgem should consider the appropriate response to this issue carefully.

The proposed drafting departs from the licence definition of $TLRRC_{ov}$

22. The handbook drafting under consultation states that “ $TLRRC_{ov}$ 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”.
23. This is not the definition in the current licence at CRC3G.3 and would represent a departure from it. As a general principle, departures from the licence should be avoided. To align to the licence, the drafting should instead cross-refer to CRC3.G.

4. The net to gross methodology

24. The net to gross methodology is relatively brief, and the only comments we have on it are either:
- a. covered in the generic issues section of this response, in section 1 above; or
 - b. detailed drafting suggestions, set out in the annexes to this response.

5. The NASD methodology

The licensee-specific deadbands must be set as soon as practicable, or it would fundamentally undermine the regulatory certainty the financial methodology is intended to bring about

25. The Ofgem decision on the NOMs methodology involves a deadband within which the incentive will not operate.² The proposed drafting simply states that the deadband will be set once “we have an understanding of the degree of robustness of the data” for each specific licensee.
26. It is important that a process be set to determine these materiality thresholds as soon as practicable and as far ahead of the end of the ED1 period as possible. The licence drafting should include a specific deadline.
27. If the deadband is instead set after the period, this would amount to giving Ofgem discretion to switch on or off rewards or penalties for individual licensees having seen the outcome of the mechanism. This would undermine the regulatory certainty that the setting of a close out methodology is intended to bring.

The reward or penalty needs to be applied as a post-tax value

28. The 2.5% reward or penalty allowed for at paragraph X.15ii needs to be calculated in post-tax terms according to CRC5D.9(b) and CRC5D.11(b).
29. Assuming the value is applied directly to revenues in the PCFM, the adjustment will need to be “grossed up” to allow for corporation tax. We have suggested some wording that could be included as an additional sub-paragraph to ensure this adjustment, at paragraph X15.v in annex 1 to this response.

² We can see no justification for this deadband in the ED1 strategy decision or final determination.

6. The high value project methodology

There are issues with the licence definition of TUCHVPF

30. As with the load related re-opener, there are issues with the licence definition of a critical value in the reopener calculation for both within period and end of period reopeners. These issues related to the total level of expenditure that is to be used in evaluating whether or not the reopener is triggered (TUCHVPF).
31. With TUCHVPF defined as it is at CRC3F.A1.2, there is a circularity between its definition (the proposed revised level of allowances) and its use in CRC3F.A1.3 in the calculation of the proposed revised level of allowances. This would be mathematically problematical and could result in an undefined value. Moreover, with TUCHVPF defined as it is, the reopener 20% of expenditure threshold would also be applied at least twice as part of CRC3F.A1.3 (first in calculating the proposed revised level of allowances and second in testing for the material amount).
32. Ofgem should consider the appropriate response to this issue carefully.

The licence does not yet contain a set of procedures for the end of period reopener

33. CRC3F of the current licence provides for the Authority to give notice of a reopener after the end of the ED1 price control period, as well as for licensees to give notice of a reopener within the period. It also includes a set of procedures to be followed when the licensee gives notice of a reopener, which are contained in CRC3F.12 to CRC3F.24³.
34. The licence does not set out the procedure to be followed by the Authority in making end-of-period reopener revisions. The procedures for determining reopener adjustments in the licence are instead limited to within period re-opener adjustments.
35. This may be because the reopeners were to take place after the end of the ED1 period and therefore the relevant procedures were left to the ED2 licence drafting. If this is the case it should now be addressed, with a set of procedures being included in the licence, since handbook methodologies for the reopener are being introduced. It would be relatively straightforward for licence drafting for HVP reopener procedures to follow the template set by the end of period load related reopener licence conditions.

We can see no provision in the ED1 licence for an innovation adjustment in relation to HVPs

36. There is no obvious provision in the licence for evaluation of avoided expenditure due to innovation in the evaluation of the tests for whether or not an HVP expenditure reopener is triggered. It may

³ Of Northern Powergrid's licences; there are three versions of these conditions so numbering may differ for other licensees.

therefore be appropriate to delete this step in the methodology, which would also have the benefit of simplifying the assessment of the reopener values.

We can see no provision in the ED1 licence for an adjustment in relation to delayed or deferred HVPs

37. The proposed financial methodology, at paragraphs D13 to D15, includes an adjustment for delayed or deferred projects. The tests set out in appendix 1 to CRC 3F are, according to CRC3F A1.4, to be evaluated “on a total expenditure basis taking account of expenditures incurred, or expected to be incurred, over the entire Price Control Period”.
38. We can therefore see no basis for an adjustment for delayed or deferred projects in the evaluation of TUCHVPF.
39. This implies that this step should be removed; consequently, allowances at ED2 would need to be set cognisant of the possibility that delayed ED1 HVPs may see their ED1 allowances clawed back.

It is appropriate that there are no HVP output tests

40. At DPCR5, the *Final proposals* contained provisions to test the delivery of specific deliverables from high value projects (HVPs), and claw back allowances in the event they were not delivered. There was also an HVP expenditure re-opener, and also a set of over-arching network output measures (for asset loading, health and fault rates). These multiple provisions, especially the two separate close-out mechanisms specifically for HPVs, complicated the financial calculations and led to the need for multiple “double counting” scenarios to be anticipated and mitigated.⁴
41. The ED1 strategy decision, and the slow-track licence modification, differ from the DPCR5 *Final proposals* in that they make no specific mention of the HVP outputs mechanism, instead only including the expenditure mechanism. It is therefore appropriate that Ofgem’s ED1 methodologies do not contain a separate HVP outputs mechanism. The removal of this mechanism simplifies the financial methodologies significantly by significantly reducing the scope for double counting.

The double counting provision with NASDs appears appropriate, with some tweaks; we think it should be applied after the reopener thresholds are evaluated

42. With no provision for a specific HVP output assessment, the necessary double counting adjustments are greatly simplified, compared to DPCR5.
43. The only potential double counting scenario we have identified would occur if an HVP expenditure adjustment was combined with a NASD output adjustment. With some small adjustments, the drafting proposed ensures that the amount clawed back in total equals the HVP expenditure adjustment that would be due if only that provision were triggered.

⁴ For example, if a high value project had never been started, this could have triggered the HVP expenditure reopener (resulting in full claw back), the HVP outputs reopener (resulting in full clawback) and could have resulted in additional clawback if the network output clawback had been triggered.

44. We believe that this adjustment should be made after the evaluation of the thresholds for whether or not the HVP reopener is triggered, as the thresholds for that evaluation are specified in the licence and allow no scope for it. In spite of this, we think the licence may still allow scope for the double counting adjustment itself to be made after the evaluation of the threshold tests. This is because the licence requires that any proposed adjustment to allowances “*constitutes an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of this licence.*” Overall, therefore, it appears likely that the adjustment can (or indeed must) be made, but that any such adjustment should be made after the HVP reopener thresholds are evaluated, not before.

7. The Shetland reopener

The licence does not yet contain a set of procedures for the end of period reopener

45. As with the load related reopener, SSEH’s current licence states that the Authority can trigger a reopener in a window after the end of the ED1 period but sets out no procedures for the Authority to follow at that time (instead it only a set of procedures for within period reopeners).
46. Since HVPs and the Shetland reopener are covered by the same licence condition (CRC3F), addressing this point in relation to HVPs, and adding a set of “end of period” procedures, would also address it in relation to the Shetland reopener.

8. The generic financial adjustment methodology

The profiling adjustments in the drafting need to be adjusted to match the consultation

47. The main consultation document states the basis on which allowance adjustments are to be profiled over the ED1 period. In general we support the approach of using ED1 allowances for this profile, since (in the event of claw back) this means that Ofgem would be clawing back allowances from the years in which they were provided. We note Ofgem has proposed this for all the methodologies, with the exception of NASD where a separate Ofgem decision concluded on the use of licensee expenditure.
48. The drafting set out in Annex E, the generic financial adjustment, instead links the profiling to expenditure in some cases (high value project costs) and to total allowances, which lacks a profile, in others (e.g. load related expenditure). We have proposed edits to the drafting, and the table, that would align the financial profiling of allowance adjustments with the proposals in the main body of the consultation.

Annex 1 to Nothern Powergrid’s response to the ED1 close out methodologies consultation

Below we provide tracked change edits, and comments, on the drafting proposed for the annexes to the ED1 legacy financial handbook chapter.

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

This section of the financial handbook details the financial methodologies that the Authority will follow in respect of the provisions made in CRC3G, CRC3F, CRC5D and CRC5G to adjust ED1 Price Control Period expenditure allowances after the end of the ED1 Price Control Period in certain circumstances.. They do not set out the calculations to be used under any other provisions in those licence conditions.

All calculations under this section of the financial handbook are to be undertaken in 2012/13 prices using the ED1 Price Control Period price base except where otherwise stated.

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

Overview

- X.1 CRC 3G sets out the a-mechanism for revising the licensee’s allowed ~~level of~~ Load Related Expenditure for the regulatory years 2015/16 to 2022/23, where ~~itsthe licensee’s~~ actual load related expenditure was higher or lower than the licensee’s allowed Load Related Expenditureits 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 ~~bBase dDemand fRevenue~~ 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 **Price Control Period** Load Related Re-opener revenue adjustment

- X.3 CRC 3G.7 and 3G.10 ~~necessitate that~~require the Authority to evaluate an efficient value of ~~Load Related Expenditure for the regulatory years 2015/16 to 2022/23, known as TLRRCF for the regulatory years 2015/16 to 2022/23 (which is defined in CRC 3G.6(a) as “the level of efficient Load Related Expenditure over the Price Control Period”)~~ and CRC 3G.7. Under CRC 3G.7, the value of TLRRCF is used for comparison with the opening level of allowed expenditure (TLRRCov) ~~which, under is defined in 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 be (i) in accordance with CRC 3G.24; (ii) specify revised values for the licensee’s opening RAV balance and bBase dDemand fRevenue for the ED2 period (CRC 3G.20), and the years to which the

Comment [A1]: This will necessitate a new defined term for the legacy item, as will many terms

Comment [A2]: The adjustment to "opening RAV balance" referred to at X2, X5 and X8 is not aligned to the licence. However, since it is an NPV neutral timing difference, this may not be contentious.

Comment [A3]: The drafting in the second sentence of X2 was originally proposed to define terms with reference to the ED1 licence. But if Ofgem is to move away from this approach it would seem sensible to use the standard convention in the financial handbook – which is to refer to terms defined in the current licence (or define the terms in the glossary with reference to the licence). Using the standard convention necessitates no explanation and this sentence can be deleted.

The move to terms being defined in the current licence, rather than the ED1 licence as was the case in earlier working group drafts, creates two issues:

(1)a far larger number of legacy ED1 terms will need to be defined in the ED2 licence

(2) there is a greater chance of unintended consequences such as changes to the ED1 settlement, e.g. if a future change to a “generic” term used in both ED1 and ED2 affects the close out result.

In making this change relative to the working group assumption, Ofgem must take care to ensure these issues are properly dealt with.

Comment [A4]: The licence definition of TLRRCF causes an issue which is detailed in our consultation response and which Ofgem must consider the appropriate response to. In short, it results in a circularity in one of the key reopener equations.

Comment [A5]: This proposed drafting in fact departs from CRC3G. It also presents an impossible requirement, since the latest value of LRRC may be after any revisions under part A of CRC 3G. A reference to CRC3G.3 should be used instead.

determination applies (CRC 3G.24(a)); and (iii) The Authority will undertake the steps, given in paragraph E.1 of follow the methodology set out in Annex E: General Financial Adjustment Methodology, in order to calculate those values.

- X.6 The Authority will consult the licensee on its provisional determination, and will allowing the licensee at least 28 days from the date of that provisional determination in which to respond.

ii) Net to gross adjustment for **ED1 Price Control Period** 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, in circumstances where the Authority has not given the licensee 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 revenue for the ED2 Price Control Period under CRC 5G.14, after the end of the 2022/23 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-open net to gross 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 requires the Authority to evaluate whether the licensee has provided adequate justification for why the Relevant Expenditure has fallen outside a Specific Customer Funded Reinforcement Percentage Band. If the Authority determines the licensee has not provided such adequate justification, the Authority will determine the value of relevant adjustments. In carrying out that evaluation, the Authority will follow the methodology that will be followed in evaluating the licensee's justification is set out at Annex BA: ED1 net to gross assessment methodology.

- 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 ED2 Price Control Period. The Authority will follow the methodology set out in undertake the steps given in paragraph E.1 of Annex E: General Financial Adjustment Methodology in order to calculate that value.

iii) **ED1 Price Control Period** 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 opening RAV balance and base demand revenue for the ED2 Price Control Period and revisions to ED2 opening RAV balance in respect of the licensee's delivery of Network Asset Secondary Deliverables ("NASD") in the ED1 Price Control Period, as required by the latest version of licence condition under CRC 5D of the ED1 licence.

- X.12 The Authority's will follow the methodology for assessing delivery of NASD in ED1 the ED1 Price Control Period is set out in Annex BC: ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology.

- X.13 If the Authority makes a determination under CRC 5D.9, that determination must (i) specify revised values for the licensee's opening RAV balance and base demand revenue for the ED2 Next Price Control period; and (ii) set out, in accordance with CRC 5G.13, 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

Comment [A6]: The current licence uses the term "price control period" to refer to ED1 and "next price control period" to refer to ED2. If this convention is maintained, the meaning of these terms will change at the start of the ED2 period. Therefore we have assumed in our comments on the drafting that the new terms "ED1 price control period" and "ED2 price control period" the equivalent for will be introduced. These terms could be shortened to "ED1 period" and "ED2 period".

Comment [A7]: Although the net to gross methodology refers to "opening RAV balance" (e.g. at X.10) there is no mention of this in CRC 5G. This may however be non-contentious because the departure would be net present value neutral.

Comment [A8]: Although the NASD methodology refers to "opening RAV balance" (e.g. at X.11) there is no mention of this in CRC 5D. However, since it is an NPV neutral timing difference, this may not be contentious.

~~E.1~~ follow the methodology set out in Annex E: General Financial Adjustment Methodology in order to calculate these values.

X.14 If, under the Methodology set out in Annex C: ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology, the Authority determines that an ED1 NASD Allowance Adjustment Value is required ~~for~~ in respect of the ED1 Price Control Period, the Authority will (i) ~~obtain~~ determine the ED1 NASD Allowance Adjustment Value ~~from~~ in accordance with ~~Stage 7~~ of set out in Annex C: the ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology; and (ii) ~~undertake~~ follow the steps E.1 (ii) to (ix) ~~given~~ set out in paragraph E.1 of Annex E: General Financial Adjustment Methodology in order to calculate these values.

X.15 If, under the Methodology set out in Annex C: ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology, the Authority determines that a penalty or a reward is required, the Authority will apply the following steps:

- i. ~~Obtain~~ Determine the ED1-NASD Allowance Adjustment Value ~~for the Price Control Period in accordance with~~ from stage 7 of set out in Annex C: the ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology;
- ii. Multiply the value obtained in step X.15 (i) by 2.5 and divide by 100 to determine the reward or penalty value;
- iii. Adjust the value calculated at X.15 (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-Next Price Control Period, using:
 - a. Retail Price Inflation to translate the values to April 2023 prices; and then
 - b. ~~The~~ The relevant inflation measure for the ED2-Next Price Control Period to translate the values calculated at under X.15 (iii) a to the relevant price base for the ~~Next~~ Price Control Period; and
- 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 the 2025/26, 2026/27 and 2027/28 regulatory years respectively.
- v. "Gross up" the values calculated at X.15 iv for corporation tax in the relevant years, to ensure that the post-tax penalty or reward is 2.5 per cent as specified in CRC 5D.9(b) or CRC5D.11(b).

Comment [A9]: The 2.5% reward or penalty allowed for at paragraph X.15ii needs to be calculated in post-tax terms according to CRC5D.9(b) and CRC5D.11(b). Assuming the value is applied directly to revenues in the PCFM, the adjustment will need to be "grossed up" to allow for corporation tax. We have suggested some wording at X15v

Determination of the ED1 Price Control Period ED1 NASD allowed 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 in accordance with CRC 5D.14, and will allow 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. The Authority will be not determined by the Authority by 30 November 2023 a NASD allowed revenue adjustment for the ED1 Price Control Period for the purpose of determining revised ED2 Price Control Period PCFM values before 30 November 2023.~~

X.18 The Authority will use the methodology set out in this paragraph to determine any ED1-NASD Adjustment in respect of the ED1 price control period revenue and RAV adjustment values for the

Comment [A10]: The methodology that paragraph X.18 says is set out in that same paragraph isn't set out in this paragraph i.e. X.18, so which methodology is being referred to?

licensee by 30 November 2024 ~~for the purpose of determining revised ED2 PCFM values by 30 November 2024.~~

X.19 ~~No~~The Authority will not determine any further revisions to the ED1 NASD allowed revenue and RAV adjustment values ~~for~~NASD adjustments in respect of the ED1 Price Control Period for the licensee ~~will be determined after 30 November 2024 for the purpose of determining revised ED2 PCFM values for the next Price Control Period.~~

iv) ~~ED1 Price Control Period~~ High Value Projects (HVP) adjustments

Overview

X.20 CRC 3F sets out ~~the~~a mechanism for revising the licensee’s allowed level of expenditure on High Value Project Costs ~~_upwards or downwards for the regulatory years 2015/16 to 2022/23~~ED1 price control period. ~~Such revisions may reflect overspend or underspend on existing high-value investment projects catered to by the licensee’s existing High Value Project Costs expenditure allowance or expenditure on investment projects not catered to by that existing allowance, 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~~a relevant adjustment to the licensee’s ~~Aggregate Baseline Expenditure Allowances~~ ~~for~~allowed level of expenditure on High Value Project Costs ~~following any proposal it makes under CRC 3F.8,~~ after the end of the ~~2022/23~~ 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 Notice window for the Authority to give Notice of its proposal to make a relevant adjustments ~~in respect of High Value Project Costs.~~ Appendix 1 of CRC 3F ~~details-sets~~ the tests ~~for to be applied to any proposed relevant adjustments the Authority proposes~~ in relation to High Value Projects ~~e~~Costs, as well as the relevant material amount for ~~each the~~ licensee. ~~This section deals only with adjustments at the end of the RHO-ED1 period.~~

Calculation of ~~RHO-ED1~~the Price Control Period HVP Re-opener adjustment

X.23 CRC 3F.8, CRC 3F.9, and Appendix 1 of CRC 3F allow the Authority to determine an adjustment to the allowed level of efficient adjustment to expenditure on 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-are~~ both 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 Authority will follow the methodology ~~that will be followed by the Authority in~~for evaluating TUCHVPF ~~is~~ set out ~~at in~~ Annex D1: High Value Projects Closeout Methodology.

X.24 If the Authority makes a determination under CRC 3F ~~.21~~[new part of licence condition to be created] (or CRC 3F.29[new part of licence condition to be created] 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 ~~Costs for each regulatory year.~~ The Authority will ~~undertake the steps, given in paragraph E.1 of~~follow the methodology set out in Annex E: General Financial Adjustment Methodology, in order to calculate ~~these values~~the consequential revisions to the opening RAV balance and base demand revenues for the ED2 Price Control Period.

Comment [A11]: Paragraph X.20 does not appear to cater to the scenario of a new high value investment project. We have proposed drafting to cover this scenario. The methodology itself already seems to cater to it.

Comment [A12]: Since a term defined in the licence is being used, the reference to the licence is superfluous.

Comment [A13]: CRC3F.8 doesn’t use the term “Aggregate Baseline Expenditure Allowances”. This proposed change follows the wording of CRC3F.8

Comment [A14]: X.22 makes a statement that is true of all of the legacy financial instruments. It would seem to be better to include it instead as a statement at the very start of the whole handbook section e.g. “This section of the financial handbook details the financial methodologies that the Authority will follow in respect of the provisions made in CRC3G, CRC3F, CRC5D and CRC5G to adjust ED1 Price Control Period expenditure allowances after the end of the ED1 Price Control Period in certain circumstances.

Comment [A15]: This adjustment aligns the terminology with that used in CRC 3F.8.

Comment [A16]: The reference in X.23 to the licence definition of TUCHVPF is superfluous, since defined terms have the meaning in the licence. Moreover, the licence definition appears to have a critical issue. We explain this issue in our consultation – in short it causes a circularity in the calculation of a key reopener value. Ofgem should consider the appropriate response to this issue carefully.

Comment [A17]: The relevant cross reference has already been given and that should be all that is necessary; stating the definitions seems superfluous.

Comment [A18]: X24 refers to determinations under CRC 3F.21, but this licence provision relates to within period re-openers only. The provisions for a determination in the close-out reopener have not yet been included in the licence. The drafting in X24 should therefore be updated to refer to this new part of the licence, once included. It is also unnecessary to specify annual values under X.24, since the General Financial Methodology deals with profiling across the period.

Determination of ~~RHO-ED1~~Price Control Period HVP Re-opener adjustment value

- X.25 The Authority will use any revised expenditure allowance amounts to determine the ~~RHO-ED1~~High Value Project Costs Re-opener adjustment values for the Price Control Period for the licensee by 30 November 2024, for the purpose of determining ~~the value of~~revised PCFM values for the ED2 Price Control Period.
- X.26 ~~No~~The Authority will not determine any further revisions to the ~~RHO-ED1~~High Value Project Costs Re-opener adjustment values in respect of the ED1 Price Control Period for the licensee ~~will be determined~~after 30 November 2024 for the purpose of determining revised ~~RHO-ED2~~PCFM values for the Next Price Control Period; but this ~~is~~shall be without prejudice to any requirement for the licensee to restate the values referred to in paragraph X.24 for any other purpose.

Comment [A19]: The drafting in X25 and X26 appears to follow the DPCR5 model; it is not clear how this will relate to the ED1 close out reopener, and this should be revisited once a set of procedures for the close out reopener have been drafted (which should presumably mirror those for the close out load related reopener).

Annex 2 to Nothern Powergrid's response to the ED1 close out methodologies consultation

Below we provide tracked change edits, and comments, on the drafting proposed in the consultation for the annexes to the proposed financial handbook chapter.

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 (i.e. TLRRCF, the total over the ED1 Price Control Period of the licensee's LRRCF, as that acronym is defined in CRC 3G.6a7) for the purpose of making a determination under CRC3G.20 of any revisions that are to be made to the licensee's opening RAV balance and Base Demand Revenue for the Next Price Control Period.

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 ~~a~~Assessment;
- Step 4: Assessment of expenditure avoided through innovation; and
- 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 specified~~ in CRC 3G.16, and will use this that assessment to inform its decision on whether or not to give a Notice under CRC 3G.6.

A.4 In undertaking the initial assessment set out in paragraph A.3 this analysis, the Authority will consider the licensee's allowed and Actual Load Related Expenditure ~~on the basis set out in accordance with~~ 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 ~~ing~~, but ~~is not be~~ limited to, ED1 submissions made in accordance with RIGs submissions and any other relevant submissions made by the licensee during the ED1 Price Control Period).

A.5 The Authority will inform the licensee of the results of the initial assessment undertaken under paragraph A.3 Initial High Level Analysis, including where those results indicate that ~~no a~~ reopener is not necessary and, therefore, that the Authority will not give the licensee a Notice under CRC 3G.6 ~~will be given~~. Where ~~it also the Authority does~~ gives a Notice ~~under CRC 3G.6~~, in accordance with ~~the timescales specified in~~ CRC 3G.16, ~~it the Authority~~ 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 given under CRC 3G.6, or where the licensee considers that further information or analysis would be

relevant ~~following as a result of the giving of~~ a Notice under CRC 3G.6, ~~the licensee~~ will provide ~~this~~ ~~that~~ 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 ~~EF: Performance Assessment Submission~~.

Step 3: Efficiency Assessment

~~A.7 In accordance with CRC 3G.6(a), defines~~ LRRCF is defined with reference to efficient costs. ~~In undertaking its assessment of 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 efficient Load Related eExpenditure, the Authority will interpret efficiency to mean investment decision-making by a licensee that:

- i. ~~It~~ 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 decision(s); and,
- ii. ~~It~~ Resulted in Load Related eExpenditure during the Price Control Period that would reasonably, at the time of making the relevant decision(s), have been expected to be required in order to meet the changing and uncertain needs and requirements of the licensee’s electricity dDistribution sSystem.

A.9 Subject to paragraph A.8, the Authority’s view-assessment of LRRCF will be equal to the same as 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 does not~~ consider to have been efficient; and,
- ii. ~~It~~ The licensee has not provided a supporting explanation justification of why the schemes, programmes or items of Load Related Expenditure identified by the Authority under paragraph A.9 (i) were efficient, which is adequate in the Authority’s reasonable view.

A.10 Where an efficiency adjustment is made to LRRCF, its the value of that adjustment will be limited to the value of the factors identified under paragraph A.9. ~~No-The Authority will not make an 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. Consider how the licensee conducted and executed the relevant decision-making processes and procedures ~~of the licensee were used and executed~~ in practice, including the 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”*.

Comment [A1]: This entire sentence is about how the PAS is used, which involves more than the efficiency assessment. Move it to step 2?

Comment [A2]: CRC3G.21(d) describes a different innovation adjustment. However the sentence does not make grammatical sense and would also require further methodology content in order to make operational. Since CRC3G.11 states that all calculations will be undertaken on the basis it sets out, we presume this wording takes priority, but Ofgem should still carefully consider the appropriate response to this issue.

A.13 In its evaluation of TLRRCF and 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. ~~e~~Cost-benefit or other financial analysis submitted by the licensee that demonstrateing 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 include~~ing information explaining and justifying any assumptions that have been made; and
- ii. ~~e~~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 under paragraph 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. ~~t~~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. ~~t~~The costs ~~that were the licensee~~ incurred ~~by the licensee~~ in delivering the Innovative Solution(s), 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 assessment 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 adjustment and add any innovation adjustment in accordance with Ssteps 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 opening RAV balance and 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 the 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 as 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 the following two main steps:
- Step 1: Licensee performance report: and
 - 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 by 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 its Relevant Expenditure 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. The licensee must provide a report is required under CRC 5G.8 when either situation arises.
- B.7 CRC 5G.9 specifies the type of information required within the report required under CRC 5.8 should contain. In preparing thate 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 as to why the licensee's Relevant Expenditure has fallen 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 together with other relevant information, in order to carry out a qualitative assessment of whether the justification provided by the licensee adequately explains why the actual Customer Funded Reinforcement Percentage is has fallen 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 that may affecting the outcome, there is no simple mechanistic calculation that can be performed. The Authority will, therefore, need to review the justification provided by the licensee and determine whether or not there is sufficient justification ~~not~~ to determine a relevant adjustments.

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

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

Overview

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

- 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 control periods. For ~~E~~lectricity ~~D~~istribution, NOMs are referred to as NASD in ~~ED1~~the Price Control Period.

C.3 As part of its ~~ED1~~-settlement for the ED1 Price Control Period, 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 licensees NASD 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~~the ED1 Price Control Period, ~~each-the~~ 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 a Monetised Risk Workbooks that converts 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 e~~Control~~ Period:

- 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 ~~th~~ese 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 ~~the licensees~~ with ~~their~~ ~~its~~ ED1 business plans ~~for the Price Control Period~~ were based on ~~the licensee's~~ 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 the ED2 Price Control Period~~ for justified over-delivery and unjustified under-delivery. Justified over-delivery will also be subject to a 2.5 ~~per cent%~~ reward ~~(after tax)~~, while unjustified under-delivery will be subject to a 2.5 ~~per cent%~~ ~~(after tax)~~ penalty, ~~where the percentages are measured relative to the incremental (or avoided) costs associated with the over- or under-delivery.~~
- C.10 CRC 5D also recognises ~~that~~ circumstances can change and that ~~the~~ 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.2 requires ~~the~~ licensees to submit a report by 31 July 2023 setting out the licensee's performance against NASD targets over the ED1 ~~p~~Price ~~e~~Control ~~p~~Period. ~~The Authority will use T~~his ~~P~~performance ~~R~~eport ~~will be used alongside~~ ~~together with~~ the data provided in ~~the~~ annual submissions of ~~the licensee's~~ 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, as~~ summarised below:
- Stage 1: Licensee submits relevant Non-NASDs risk changes and impact on performance against targets;
 - Stage 2: Licensee submits ~~ED1-its~~ ~~P~~NASD performance ~~R~~eport ~~for the ED1 Price Control Period;~~
 - Stage 3: The Authority assesses the relevant risk changes and ~~the licensee's~~ ~~P~~performance ~~R~~eport ~~for the ED1 Price Control Period;~~
 - Stage 4: The Authority assesses delivery against the ~~licensee's~~ 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 provided by the licensee; and~~
 - Stage 7: The Authority determines the value of the adjustment(s) required.
- C.13 Throughout the process the Authority ~~has the scope to~~ may ask ~~the licensee~~ for clarification or additional details through supplementary questions.
- C.14 ~~In making A~~ny determination, ~~by the Authority~~ which is related to High Value Project ~~e~~Costs or Link Box ~~e~~Costs under licence condition CRC 3F, ~~the Authority will give due need to be consideration to the requirements of~~ ~~ed alongside~~ this methodology ~~in order~~ to avoid double counting ~~adjustments~~ related to ~~the~~ delivery of NASD. The conclusions of ~~the any~~ determinations ~~made by the Authority~~ under CRC 3F will inform any adjustment(s) to be applied under this methodology.

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Comment [A3]: Although we have proposed detailed amendments, we propose deletion of this entire paragraph.

Paragraphs C60 and D21 include a specific, clear, double counting adjustment in respect of high value projects. If any such adjustment is necessary in respect of link boxes, a similar approach should be followed. This renders C.14, which is not specific and may be difficult to implement, unnecessary.

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 The licensee will provide ~~se details are~~ the information required under paragraph C.16 ~~to be provided~~ as part of the ~~P~~performance ~~R~~report required under ~~stage 2~~CRC 5D.2.
- C.18 Throughout the ~~ED1-Price Control p~~Period, the 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-the~~ 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; and
 - 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
<ul style="list-style-type: none">• Asset replacement• Refurbishment• High Value Projects (with asset replacement/ refurbishment)	<ul style="list-style-type: none">• General reinforcement• Faults• High Value Projects (other drivers)• Other investment activities	<ul style="list-style-type: none">• 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 licensee’s 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 licensee's 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 the licensee's NASD targets, they can affect the scale of activity that is carried out. They ~~therefore may, therefore, have a~~ be relevant ~~tee~~ to the ability of the licensee to deliver the licensee's 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 the~~ delivery of the licensee's NASD targets.

Stage 2 - Licensee submits ED1 Performance Report for the ED1 Price Control Period

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

- (a) ~~the~~ The licensee's performance against its ~~Network Asset Secondary Deliverables~~ NASD;
- (b) ~~a~~ Any performance against its ~~Network Asset Secondary Deliverables~~ NASD equivalent to or better than that set out in the ~~Network Assets Workbook~~ NAW (and converted to monetised risk measures in the Monetised Risk Workbook);
- (c) ~~a~~ Any Justified Over-Delivery against its ~~Network Asset Secondary Deliverables~~ NASD; and
- (d) ~~a~~ Any Justified Under-Delivery against its ~~Network Asset Secondary Deliverables~~ NASD.

C.27 ~~The As~~ CRC 5D.3 ~~reporting includes a~~ requirement for the licensee to incorporate justification in the performance report, it and, therefore, overlaps with the requirements of stage 5 of the high-level framework in the NOMs Incentive Methodology. ~~The Licensees will,~~ therefore, be providing some justification as part of the Pperformance Rreport, which may (if required) be supplemented with further justification provided under stage 5 of the high-level framework in the NOMs Incentive Methodology.

C.28 The scope of content of the Pperformance Rreport is covered in Annex EF: Performance Assessment Submission of this document.

Stage 3 – Authority assessment of the relevant risk changes and of the licensee's Pperformance Rreport

C.29 The Authority will review the details of the relevant risk changes and ~~performance~~ delivery against the NASD in the licensee's Pperformance Rreport submitted under CRC 5D.2 and, where necessary, the Authority may ask supplementary questions ~~if there are ambiguities in order to clarify any of 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 ~~the Authority~~ the Authority agrees with the licensee's view of delivery. This may require the

Authority to cross-checking data against with the licensee's 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 licensee's 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 licensee's NASD monetised risk target.

C.32 The outcome ~~from of~~ 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~~ Authority has gained an understanding of the degree of robustness of the data that will be provided in support of the licensee's performance on against the licensee's NASDs output targets, and will be specified in a direction by the Authority by [date].

C.36 If ~~the~~ the licensee's performance falls within the materiality threshold, ~~there is~~ Authority will not make a NOMs incentive mechanism revenue adjustment. ~~The assessment process stops.~~

C.37 If ~~the~~ the licensee's performance falls outside ~~of~~ the materiality threshold, ~~then the remainder of assessment the~~ process will continue so that the Authority is able to determine the value of the revenue and RAW relevant adjustment(s).

C.38 The Authority will provide a ~~a~~ Notice specifying ~~which either the licensee has delivered on the NASD targets (i.e. within the materiality thresholds) and which are or the licensee is required to provide justification for over-delivery or under-delivery. The~~ Authority will issue that a Notice ~~will be issued~~ by 30 November 2023.

~~C.39~~ If there is a delay Authority is unable to provideing theis a Notice under paragraph C.38 by 30 November 2023, it will inform the licensee in writing and all subsequent ~~action~~ deadlines may be revised ~~in line with the length of delay accordingly.~~

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

~~C.40~~ Where the Authority indicates that a the licensee has delivered performance outside of the materiality thresholds, the licensee will be required to provide justification for the variance to the licensee's NASD monetised risk target.

~~C.41~~ The licensee may have provided some justification as part of the performance submission report required under stage 2, but, in any event, the licensee will be given the opportunity to supplement the original submission information provided in that performance report with further justification.

~~C.42~~ The extent and nature of the justification and evidence to be provided by the licensee is not prescribed in the NOMs Incentive Methodology. However, the justification and evidence provided should be proportionate to the difference between the ED1 licensee's performance in the ED1 Price Control Period and the NASD monetised risk target, and it is noted that for Electricity

Comment [A4]: Determining these materiality thresholds after the end of the ED1 price control period would allow the Authority discretion to switch on or off the adjustments for individual licensees. This would be bad regulatory practice and undermine the incentives the mechanism is intended to provide.

Therefore a process should be set to determine these materiality thresholds in advance of the ED1 period, as soon as practicable.

~~Distribution.~~ The licensee may also refer to ~~there is~~ extensive data ~~that is~~ available from ~~submitted~~ RIGs Annex D Secondary Deliverable data templates and RIGs Annex B Costs and Volumes, ~~submitted by the 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 ~~of Justified Over-Delivery and Justified Under-Delivery in CRC 5D~~ suggest that ~~the licensee can make those~~ justifications ~~of under-delivery or over-delivery can be explained through by reference to~~ the total risk position ~~i.e. If~~ total risk increasing justifies more delivery; ~~and~~ total risk decreasing justifies less delivery.

C.44 Parts (b) ~~of Justified Over-Delivery and Justified Under-Delivery in CRC 5D~~ 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 ~~the licensee~~ 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 ~~an~~ ~~such~~ other format, ~~as~~ ~~the licensee may consider~~ appropriate.

C.47 Where relevant ~~and to assist the Authority with its analysis~~, the justification should make reference to the relevant sections of the ~~P~~performance ~~R~~report ~~required under CRC 5D, to assist the Authority with analysis of the justification~~.

C.48 The ~~licensee must submit any~~ justification ~~that may be required~~~~should be submitted~~ by 31 January 2024, or ~~by such~~ later date as determined ~~by any delays to the Authority's notice in stage 4 in accordance with paragraph C.39~~.

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 ~~the licensee's~~ NASD targets or ~~the~~ proportion of under-delivery against ~~the licensee's~~ 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; ~~and~~
- 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~~~~how~~ the Authority will ~~undertake for the~~ quantitative assessment.

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

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

Stage 7 – The Authority determines the value of the adjustment(s) required

C.55 The NOMs Incentive Methodology specifies the approaches that will be used to value over-delivery and ~~under-delivery~~ of NASD.

C.56 For under-delivery of NASD, the values will be based on the ~~ED1~~-allowed efficient costs for the ED1 Price Control Period.

C.57 For over-delivery of NASD, the values will be based on ~~Ofgem's~~ the Authority's view of efficient costs. ~~In the Authority's~~ The Decision on the Network Output Measures (NOMs) Incentive Methodology dated 6 December 2018, ~~stated that~~ the Authority stated that it would use the lower of the licensee's incurred cost and allowed unit cost. ~~Where in the event that~~ a unit cost does not exist, the Authority will subject the licensee's 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-delivery and ~~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-delivery and ~~under-delivery~~ assessment, and will still form part of the NASD adjustment. The Authority will also identify the HVP proportion value ~~will be identified separately, to be and used that value~~ in determining the value of the adjustment described in paragraph D.210.

Derivation of incentive rate for under-delivery

C.61 The Authority will derive the £ per risk point for unjustified under-delivery ~~is derived~~ from the ~~ED1~~ NASD Opening Allowances for the Price Control Period and the total NASD monetised risk target.

C.62 The ~~ED1~~-NASD Opening Allowances for the Price Control Period were not clearly stated at ~~ED1~~ the Final Determination for the Price Control Period. ~~Consequently, 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~~ the Final Determination for the ED1 Price Control Period;
- Regional labour scaling factors used in cost benchmarking at ~~ED1~~ the Final Determination for the ED1 Price Control Period;
- Smart grid cost reductions applied at ~~ED1~~ Final Determination for the ED1 Price Control Period;
- The Authority's view of RPEs at ~~ED1~~ the Final Determination for the ED1 Price Control Period;

- Interpolation used at ~~ED1~~the Final Determination for the ED1 Price Control Period;
- The appropriate costs to use where the licensee has not carried out non-like-for-like replacement activity ~~has been carried out~~, noting that costs in the licensee's Bbusiness ~~p~~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 the licensees in the licensee's~~their~~ NASD monetised risk targets.

C.63 This results in the following ~~ED1~~-NASD Opening Allowances for the Price Control Period for ~~ED~~-each licensee~~s~~:

Licensee	ED1 NASD Opening Allowance
ENWL	(to be determined)
NPGN	(to be determined)
NGPY	(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

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 for the licensee is derived from the licensee's total incurred costs for NASD-related investment during the ED1 ~~p~~Price ~~e~~Control ~~p~~Period (~~ED1~~i.e. NASD Actual Expenditure for the Price Control Period) 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 the licensee did not carry out~~re 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 to be 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 ~~or~~ over-delivery represents the ~~ED1~~ NASD Allowance Adjustment Value for the ED1 Price Control Period 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 for the Price Control Period.

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 (i.e. the ~~ED1~~-NASD Allowance Adjustment Value for the ED1 Price Control Period).
- C.90 As an example, the penalty associated with ~~the ED1a~~ NASD Allowance Adjustment Value for the ED1 Price Control Period 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 High Value Project HVP Costs to determine the actual level of efficient expenditure in respect of High Value Project Costs~~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 ~~Using information submitted by the licensee, the~~ Authority will carry out an ~~initial High Level~~ Analysis of the licensee’s ~~total opening level of allowed expenditure defined as in respect of High Value Project Costs, as set out in Appendix 1 of CRC 3F, plus any additional allowed expenditure determined under previous reopeners carried out under CRC 3F (TUCHVPov) and actual or forecast level of High Value Project Costs, relating to RHO-ED1 HVPs, in order~~ to determine the requirements ~~offer~~ the licensee’s Performance Assessment Submission (“PAS”) ~~(see to be provided in accordance with Annex F: Performance Assessment Submission 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 if an the Authority’s initial High Level Analysis~~ indicates that the licensee’s TUCHVPov is zero and that the licensee has not incurred 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~~PAS and there will be no re-opener adjustment for the licensee.
- D.6 ~~Where if an the Authority’s initial High Level Analysis~~ indicates that the licensee’s TUCHVPov is greater than zero or the licensee has incurred expenditure ~~has been incurred~~ on any project meeting the definition of ~~High Value Project~~HPV Costs set out in CRC 1B, the Authority will commence a detailed ~~P~~performance ~~A~~assessment as outlined in Step 2 to Step 5 ~~below in order~~ to determine ~~the HVP Efficient Qualifying Expenditure~~TUCHVPF for the licensee. ~~Theis Authority will use the value of HVP Efficient Qualifying Expenditure so determined will be used~~ in the calculation of a HVP Re-opener adjustment as specified in paragraph X.25 ~~23~~ of Chapter X. The Authority may also request additional information in ~~line accordance~~ with Annex F: Performance Assessment Submission ~~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~~efficient High Value Project Costs ~~to determine the licensee’s HVP Efficient Actual Expenditure~~. In undertaking this assessment, the Authority will interpret efficiency to mean investment decision~~ing~~ making by the licensee that:
- ~~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 r~~esulted in expenditure on HVPs during the ~~RHO-ED1~~Price Control ~~p~~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 d~~istribution ~~s~~System.

Comment [A5]: The methodology as written requires a number of additional defined terms; it would instead be more straightforward to use the terms already defined in the licence, spell out how efficiency and innovation adjustments are to be calculated, and then define how the term TUCHVPF (the efficient level of actual expenditure) is to be calculated based on these. This would also remedy some other deficiencies in the existing drafting, e.g. that the adjustment for NASD double counting would not be made if there was no adjustment in the innovation step.

We have suggested some edits that evolve the drafting in this direction; in particular this requires the creation of a final step – evaluation of TUCHPVF and any other values necessary for the re-opener (e.g. double counting adjustment).

Comment [A6]: 23 is the paragraph which refers into this annex D

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~~ reported High Value Project Costs was not efficient, ~~it~~ the Authority ~~will deduct use its that value in the calculation set out at step [] below. 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 ~~efficiency of the licensee's HVP Actual Incurred Expenditure~~ High Value Project Costs:

- 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~~ High Value Project Costs in the context of the information that the licensee had available, or should reasonably have had available, at the time of making its investment decision(s).

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~~ reported High Value Project Costs 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~~ the licensee applied ~~by the licensee~~ those processes and procedures to decisions relating to its ~~HVP Actual Incurred Expenditure~~ high value investment projects;
- 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 ~~the HVP expenditure~~ High Value Project Costs at the time the ~~expenditure investment~~ 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 a ~~subsequent~~ another ~~Price e~~ Control ~~p~~ Period.

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

- 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;
- Evidence that the licensee had appropriate decision-making ~~processes~~ processes and procedures in place; and that ~~these~~ those processes and procedures were applied by the licensee to the decision to delay or defer a project; and,

Comment [A7]: The tests set out in appendix 1 to CRC 3F are, according to CRC3F A1.4, to be evaluated "on a total expenditure basis taking account of expenditures incurred, or expected to be incurred, over the entire Price Control Period".

We can therefore see no basis for an adjustment for delayed or deferred projects in the evaluation of TUCHVPF.

This implies that this step should be removed; consequently, allowances at ED2 would need to be set cognisant of the possibility that delayed ED1 HVPs may see their ED1 allowances clawed back.

- 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 if 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 those 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 analyses submitted by the licensee that demonstrating the savings, relative to the costs that were allowed for in TUCHVP, that resulted from the solution adopted by the licensee compared to alternative solutions (including conventional solutions), and 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 if 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 for the licensee, as adjusted where appropriate under Step 3, for the licensee.

D.20 Where if 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.

Double counting adjustment

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

Comment [A8]: There is no HVP Network Outputs Gap assessment in the methodology, as none was mentioned in the ED1 licence, therefore this clause does appear to be necessary

Comment [A9]: If this step is retained, this provision should be shifted into the final calculation of TUCHVPF

Comment [A10]: There is no obvious provision in the licence for evaluation of avoided expenditure due to innovation in the evaluation of the tests for whether or not a reopener is triggered.

It therefore appears to be appropriate to delete this step.

Comment [A11]: This double counting adjustment ought to occur in the main body of the financial annex.

There appears to be no scope for it to be made in the evaluation of TUCHVPF, which is the subject of this annex, and evaluation of the tests set out in appendix 1.

However, according to CRC3F.8 the reopener value must be one that "constitutes an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of this licence."

Since the HVP element of the NASD adjustment can be made under a different provision of the licence, the licence appears to require this double counting adjustment; just subsequent to evaluation of TUCHVPF, in calculation of the reopener adjustment, not as part of TUCHVPF

included as part of an adjustment that can be made under CRC5D, the value of this proportion will be used for the purpose of a double counting adjustment to any adjustment under 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 to the split between load related and non-load related ~~RHO-ED1~~ HVPs for the Price Control Period.

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

- General reinforcement; or
- Fault level reinforcement;

~~And~~ non-load related ~~RHO-ED1~~ HVPs for the Price Control Period are projects with a primary driver such as:

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

Comment [A12]: This paragraph appears to repeat the general financial methodology. If this is the case, it should be deleted.

Comment [A13]: We cannot identify the purpose of paragraph D.23. It may be redundant due to changes in the methodology drafting relative to earlier drafts.

Annex E: General Financial Adjustment Methodology

- E.1 Where the Authority makes a determination of an adjustment to allowances following the end of the ED1 Price Control Period, under CRC3F, CRC3G, CRC5D or CRC5G~~for regarding any of the relevant values specified in Table E1 below~~, that determination will specify the adjustment to the opening RAV balance and Base Demand Revenue in the ED2 price control period~~regulatory years to which the determination applies, in accordance~~ in accordance with the relevant licence condition(s). In order to calculate those values, ~~The Authority will undertake the following steps to calculate these values:~~
- i. Calculate the total value of the adjustment to ED1 period cost allowances required as a consequence of the close-out, in accordance with the relevant licence conditions and section X of the Financial Handbook~~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 E1. 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 in accordance with paragraph E.1 (i) from 2012/13 prices to the price base for the ED2-Next Price Control Period, using a calculation that (in the context of the ED2-Next 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 in accordance with paragraph E.1 (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 E1 below. For UCSEFEC, UCSEBC, and UCSESPC, the value calculated in accordance with paragraph E.1at (ii) will be apportioned in line with the timing profile of adjustments set out in the Authority's determination.
 - iv. Multiply the values calculated in accordance with paragraph E.1at (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) ~~a~~Applying the relevant Time Value of Money Adjustment to each of the values calculated in accordance with paragraph E.1at (iv) to reflect deferral to the 2023/24 regulatory year; and
 - (b) ~~t~~Taking the sum of the resulting values.
 - vi. Calculate the part of the financial adjustment calculated in accordance with paragraph E.1at (v) that is to be given effect through the licensee's 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 E1-ED1 allowances been subject to the adjustments calculated in accordance with paragraph E.1at (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 in accordance with paragraph E.1at (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 in accordance with paragraph E.1at (vi) ~~a~~ the amount of depreciation that would have occurred in the Price Control Period and reflecting the asset life applied for each relevant regulatory year; and

Comment [A14]: Paragraph E1(i) needs to refer to the total adjustment to ED1 allowances calculated in the relevant re-opener methodology. It currently refers to the values specified in table E1, but those values are only appropriate for the purpose of profiling across the ED1 price control period.

Comment [A15]: This profiling requirement should be moved into table E1 for consistency with all the other reopeners.

Comment [A16]: some of the values in table E1 are actual expenditure

- (c) ~~It~~ Takes the sum of the resulting values.
- vii. Subtract the value calculated in accordance with paragraph E.1a (vi), with any necessary Time Value of Money Adjustment to place this value on a consistent 2023/24 basis for the 2023/24 regulatory year, from the total value of the financial adjustment calculated in accordance with paragraph E.1a (v) in order to calculate the adjustment that is to be made directly to the licensee's ED2 Price Control Period Base Demand Revenue, and spread this value evenly across the regulatory years ~~of that constitute~~ the ED2 Price Control Period.
- viii. Subtract from the values calculated in accordance with paragraph E.1 (vi), and ~~the values calculated E.1a~~ (vii), any provisional amounts for these values included in the calculation of ~~ED2~~ Opening Base Revenue Allowances and opening RAV balance for the ED2 Price Control Period.
- ix. Use the values calculated in accordance with paragraph E.1a (viii) as revisions to the ~~ED2 Price Control Period~~ opening RAV balance and ~~ED2~~ Base Demand Revenue for each ~~relevant regulatory year in the ED2 Price Control Period~~ in any determination under the relevant licence reference from Table ~~E1~~ below and recognising in that determination that:
- (a) ~~It~~ 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) A Time Value of Money Adjustment will be applied within the ~~ED2-Next~~ Price Control Period to each relevant value to reflect any deferral from the 2023/24 regulatory year (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	The LRRCF values <u>set out in appendix 1 to CRC3G</u>	CRC 3G.20
Net to gross adjustment	The LRRCF values <u>set out in appendix 1 to CRC3G</u>	CRC 5G.14
Network asset secondary deliverables	The Licensee's total annual <u>NASD-related expenditure in the ED1 Price Control Period</u>	CRC 5D.9 or CRC 5D.11
High value projects	<u>Expenditure allowances for High Value Project Costs set out in appendix 1 to CRC3F</u>	[licence condition still to be written and consulted upon]
Shetland	UCSEFEC, UCSEBC and UCSESPC values, as appropriate, <u>including the timing profile of adjustments set out in the Authority's determination under CRC 3F.26</u>	CRC 3F.26 <u>[licence condition still to be written and consulted upon]</u>
Link Boxes	UCLB values	[licence condition still to be written and consulted upon]

Comment [A17]: The Consultation states that the adjustment will be spread over the period based on allowances for LRE and HVP costs (e.g. allowances will be clawed back in proportion to when they were provided) but the reference in table E1 is to TLRRCF and High Value Project costs, which relate to the actual level of expenditure. The correct references, based on the consultation, should be the "the LRRC values set out in Appendix 1 to CRC3G". and

Comment [A18]: If a total is used for the NASD "relevant value" in table E1, it will lack the necessary annual profile. Annual values are necessary instead.

Comment [A19]: CRC3F26 cannot be used in table E1 for the Shetland "relevant licence reference" because CRC3F26 of SSE's licence only relates to within period reopeners. The relevant licence reference needs to be the condition under which determinations will be made after the end of the ED1 period. This is yet 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](#).
- F.3 The Authority will only request [that the licensee includes](#) information in the PAS, ~~where it if the Authority~~ identifies gaps in its existing information, or where specific questions have arisen as a result of ~~its the Authority's initial High Level Analysis~~. The [Authority will only request](#) information ~~requested by the Authority will be from the licensee that is~~ proportionate to the results of the ~~Authority's initial High Level Analysis~~ and will include any ~~outstanding information~~ [the Authority may reasonably](#) required ~~in order~~ to address ~~the~~ issues identified ~~by the Authority~~.
- F.4 Following [completion of](#) the ~~initial High Level Analysis~~, the Authority will inform the licensee of any specific information [in relation to LRE, NASDs, HVPs and Link Boxes the licensee is](#) required to ~~be~~ submitted in its PAS, ~~in relation to LRE, NASDs, HVPs, and Link Boxes~~. The [Authority will request that](#) information ~~will be requested in accordance with~~ [by reference to](#) the paragraph numbering outlined in this ~~Annex F~~.
- F.5 In submitting [the](#) information [requested by the Authority](#), the licensee may be required to set out how it has ensured the robustness of ~~its data~~ [that information](#).

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~~ [licensee's PAS](#) should explain any data quality issues [encountered](#) 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 [relevant](#) scheme including:
- i. ~~The~~ [The](#) original technical solution;
 - ii. ~~A~~ [Any](#) changes to ~~that~~ [the](#) technical solution along with an explanation of the reason for changing the solution;
 - iii. ~~Where~~ [Where](#) relevant, information on Load Indices or utilisation relevant to the scheme; [and](#)
 - iv. ~~Any~~ [Any](#) relevant financial or cost benefit analysis, or analysis of options, ~~the licensee undert~~ [taken by the licensee](#) at the time [the licensee made](#) decisions on expenditure ~~were made by the licensee~~.

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 PAS:

- i. ~~a~~An explanation of changes in the volume and mix of connection schemes;
- ii. ~~i~~Information on any trade-off ~~for~~ relationship with General Reinforcement; and
- iii. ~~i~~Information on changes to the number of connections carried out by independent connection providers, compared to those anticipated in the licensee's ~~ED1 Price Control Period~~ 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 PAS:

- i. ~~a~~An overview of Primary General Reinforcement expenditure carried out during the ~~ED1 Price Control Period~~;
- ii. ~~i~~Information on load indices and utilisation;
- iii. ~~f~~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; ~~and~~
- iv. ~~f~~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 PAS:

- i. ~~a~~A narrative of its secondary reinforcement expenditure in the Price Control ~~p~~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 licensee's ED1 Price Control Period 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 ~~RHO-ED1 Price Control Period~~ ~~B~~business ~~P~~plan); ~~and~~
- ii. ~~i~~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 PAS a narrative ~~of regarding~~ its Fault Level reinforcement expenditure for the Price Control Period that:

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

- ii. ~~include~~ 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~~ PAS a narrative ~~of regarding~~ 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 ~~RHO-ED1~~ Price Control Period 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: ED1 Load Related Re-opener Closeout Methodology, the Authority may require the licensee to include in its ~~Performance Assessment Submission~~ PAS:

- i. ~~a~~ 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~~ 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~~ A demonstration that the Innovative Solutions were in the interests of Customers along with details of alternative solutions considered by the licensee;
- iv. ~~a~~ A demonstration that the ~~innovative~~ Solutions avoided costs and 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 ~~innovative~~ Solutions should be recognised);
- v. ~~f~~ Financial or cost benefit analysis ~~is~~ to demonstrate the Innovative Solutions delivered (or are continuing to deliver) benefits ~~to for~~ Customers; and
- vi. ~~a~~ 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 ~~the Performance Reports~~ required by stages 1 and 2 ~~of the Network Asset Secondary Deliverables Close-out methodology~~ and ~~the Justification Reports~~ required by stage 5 of ~~the Annex C: ED1~~ 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 ~~P~~performance ~~R~~report.

Performance against target

F.19 The licensee should specify its view of performance against the NASD monetised risk target. This should draw upon and/or make reference to data submitted within the licensee's RIGs Annex D data templates and in the licensee's Network Asset Workbooks and 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; or
- 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; or
- 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-are~~ 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 ~~P~~performance ~~R~~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 ~~P~~performance ~~R~~report the licensee must submitted by 31 July 2023. The NOMs Incentive Methodology recognises that justification can be provided as part of the ~~P~~performance ~~R~~report and ~~provides~~ guidance on the types of data and analysis is provided in Appendix 1 of the NOMs Incentive Methodology.

F.28 Where relevant, the licensee should provide:

- i. ~~a~~An explanation of the drivers of the licensee's NASD Interventions and the supporting rationale for those Interventions undertaken in the ~~ED1-Price Control~~ ~~p~~Period;
- ii. ~~a~~An explanation of trade-offs between HI Asset Category Interventions i.e. how the licensee has reprioritised work across HI Asset Categories and a justification as to why the reprioritisation was appropriate; and
- iii. ~~A~~an explanation of trade-offs between asset replacement and refurbishment work and why, in the licensee's view, the ~~is~~ particular trade-off was appropriate.

F.29 Taking into account all this information, the licensee's ~~P~~performance ~~R~~report should set out and justify the licensee's view as to whether the licensee's NASD ~~i~~nterventions ~~delivered by the licensee~~ represent an efficient outcome for ~~e~~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-If~~ the Authority determines that a licensee has delivered monetised risk outside the materiality threshold (deadband) around the NASD monetised risk target, the licensee is will be required to submit a ~~j~~ustification ~~R~~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 ~~P~~performance ~~R~~report to be submitted by 31 July 2023.

F.32 The ~~j~~ustification ~~R~~report supplements the justification already provided by the licensee 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 ~~j~~ustification ~~R~~report.

3 High Value Projects

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

F.35 The Authority may require that the licensee's ~~Performance Assessment Submission~~ PAS ~~may be required to include~~ summary information on:

- i. ~~£~~The HVPs that the licensee has completed during the ~~RHO-ED1~~ Price Control ~~p~~Period;
- ii. ~~£~~The HVPs that the licensee deferred or delayed into later price control periods or cancelled during the ~~RHO-ED1~~ Price Control ~~p~~Period;

iii. ~~The HVPs that the licensee has started during the RHO-ED1 Price Control period, but will not complete until the RHO-ED2 Next Price Control period; and,~~

iv. ~~The licensee's investment decision-making processes relating to RHO-ED1 HVPs completed during the Price Control Period.~~

~~HVP Actual Incurred expenditure~~ High Value Project Costs

F.36 The licensee may be required to provide information to support the technical, regulatory and economic need for its ~~RHO-ED1 HVP Actual Incurred Expenditure~~ High Value Project Costs in the ED1 Price Control Period. This may include, but is not limited to, the following:

i. ~~A~~ a statement of the original needs case for individual investment projects relevant to ED1 High Value Project Costs ~~RHO-ED1 HVPs~~ and whether the needs case changed (where applicable);

ii. ~~A~~ a analysis or data to support the need for each individual ~~RHO-ED1 ED1 Price Control period high value project HVP~~ including information on the drivers of the expenditure at the time the investment decision was made;

iii. ~~Relevant financial or cost benefit analysis~~ is, undertaken by the licensee at the time decisions on investment projects relevant to ED1 Price Control Period ~~RHO-ED1 HVP Price Control Period~~ expenditure were made by the licensee;

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

v. ~~A~~ a arrangements for the management and delivery of ~~RHO-ED1~~ HVPs in the Price Control Period.

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~~ must 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 ~~RHO-ED1 Price Control period~~.

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

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

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

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

F.39 ~~Where~~ If required to provide information on Avoided HVP Expenditure, the licensee should use a financial or cost benefit analysis to demonstrate how the Innovative Solutions deliver benefits to ~~e~~ Customers and present evidence of the decision making process. This should include evidence that the proposed Innovative Solutions ~~differs~~ from other conventional solutions that were in widespread use by the licensee or other licensees when addressing a need for HVP expenditure at the beginning of ~~RHO-ED1 the Price Control Period 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 an alternative investment solution relative to the adopted Innovative Solutions.

Comment [A20]: As highlighted in relation to the draft financial handbook annex on HVPs, the ED1 licence makes no allowance for adjustments on account of delayed or deferred HVPs. This content should be deleted.

Comment [A21]: This makes the assumption the current defined term will be modified in future; under the current licence definitions the term "High Value Project Costs"

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 SubmissionPAS:

- i. aA description of the Agreed RHO-ED1 Network Outputs for each individual ~~RHO-ED1~~ HVP completed in the Price Control Period; and,
- ii. aA variance analysis of the type and volume of HVP assets that were forecast to be delivered by the licensee during the ~~RHO-ED1-Price Control p~~Period and the type and volume of assets actually delivered by the licensee for each individual ~~RHO-ED1~~ HVP completed in the Price Control Period.

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

- i. ~~i~~Information on Delivered HVP Network Outputs and an assessment against Agreed HVP Network Outputs;
- ii. ~~w~~Where applicable, information and reasoning behind any failure to deliver Agreed HVP Network Outputs; and,
- iii. aAny other relevant information, such as cost benefit analyses, relating to individual ~~RHO-ED1~~ HVPs completed in the Price Control Period.

F.42 ~~Where-If~~ the licensee has not delivered Agreed HVP Network Outputs for an individual ~~RHO-ED1~~ HVP completed in the Price Control Period, the licensee’s Performance Assessment SubmissionPAS must state whether the failure to deliver the relevant outputs is due to:

- i. ~~t~~There being a change in scope of the project’s Agreed HVP Network Outputs; or
- ii. ~~c~~ancellation of the project; or
- iii. ~~t~~The project being deferred or delayed partially or in its entirety into ~~RHO-ED2~~the Next price Control Period; or
- iv. ~~t~~There being a change in project scope.

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

- i. aA 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. sSupporting information on the decision-making processes, technical and financial and/or cost benefit analyses (where applicable) from the time of the project investment decision which supports the reasoning behind the change in project outputs;
- iii. An analysis of the impact of the changes in outputs on the overall costs and timescales for delivery of the project; and,
- iv. aAn assessment of whether the outputs have been delivered and whether the Delivered HVP Network Outputs are in the interest of ~~consumers~~Customers.

Comment [A22]: There is no provision in the methodology for an HVP Network outputs gap adjustment, and therefore paragraph’s F.40 to F.43 in the section “HVP Network Outputs Gap” are redundant and should be deleted.

Comment [A23]:
As we highlight in response to the methodology, we can identify no basis in the licence for an adjustment to the re-opener outcome on account of whether or not allowances have been made in ED2 for a delayed ED1 project. If this adjustment is removed, paragraphs F44 to F46 would be redundant and should be deleted.

- F.44 For projects that were cancelled and did not start during the ~~RHO-ED1~~Price Control period, the licensee must submit an explanation of why the project ~~has not gone~~ ahead. The licensee's ~~Performance Assessment Submission~~PAS should provide:
- i. ~~s~~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. ~~i~~nformation 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 ~~RHO-ED1~~the Price Control Period and have been partially deferred into ~~RHO-ED2~~the Next Price Control Period, the licensee must provide in its ~~Performance Assessment Submission~~PAS:
- i. ~~s~~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 ~~RHO-ED2~~the Next Price Control Period;
 - ii. ~~d~~etails and reasons behind delays in project start and/or delivery or other re-phasing of the work;
 - iii. ~~a~~n assessment of whether the outputs have been delivered in a manner that is deemed to be consistent with the definition of efficiency in paragraph D.7 of Annex ~~DC1: ED1 High Value Projects Closeout Methodology~~ and whether the Delivered HVP Network Outputs are in the interest of ~~consumers~~Customers; and,
 - iv. ~~a~~n 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. ~~w~~Where there is no additional allowance for the project in ~~RHO-ED2~~the Next Price Control Period:
 - (a) ~~a~~n estimate of the costs that will be ~~spent-incurred~~ in ~~RHO-ED2~~the Next Price Control Period to complete the project; and,
 - (b) ~~a~~ description of the outputs which were not delivered during the ~~RHO-ED1~~Price Control ~~p~~Period and are expected to be delivered during ~~RHO-ED2~~the Next Price Control Period including the timing of this work; ~~and~~
 - ii. ~~w~~Where there is an additional allowance for the project in ~~RHO-ED2~~the Next Price Control Period:
 - (a) ~~a~~ summary of ~~RHO-ED1~~expenditure for the project in the Price Control Period against the relevant ~~RHO-ED1~~Price Control Period allowance and ~~new RHO-ED2~~allowance for the project in the Next Price Control Period;
 - (b) ~~a~~ revised forecast of actual expenditure in ~~RHO-ED2~~ED2 Price Control Period; and,

- (c) ~~a~~A description of the outputs which were not delivered during the ~~RHO-ED1~~ED1 Price Control ~~p~~Period and are expected to be delivered during ~~RHO-ED2~~the Next Price Control Period including the timing of delivery of ~~th~~ose outputs.

4 Link Box Costs

- F.47 The extent of the narrative and supporting evidence provided to the Authority should be proportionate to the degree ~~that to which~~ the licensee's Actual ~~RHO-ED1~~Link Box Replacement Volumes for the ED1 Price Control Period are higher or lower than the Allowed ~~RHO-ED1~~Link Box Replacement Volumes for the ED1 Price Control Period. This applies to SPN and SPMW only.
- F.48 The ~~Performance Assessment Submission~~licensee's PAS should explain any data quality issues encountered over the ED1 Price Control Period that have impacted the costs associated with the Actual ~~RHO-ED1~~Link Box Replacement Volumes for the ED1 Price Control Period.
- F.49 The licensee should provide Aany explanation of changes to activities ~~should be given~~ relative to the activities that could reasonably assumed to have been catered for in the Allowed ~~RHO-ED1~~Link Box Replacement Volumes for the ED1 Price Control Period.