Making a positive difference for energy consumers

# Decision

| Decision on the closeout methodologies for RIIO-ED1 | | | |
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The current electricity distribution price control (RIIO-ED1) will end on 31 March 2023. This document provides the detail of the methodologies that will be used to deal with uncertain costs within the price control and, in some cases, the delivery of outputs against specified targets. The final versions of these methodologies will be included in the RIIO-ED2 Financial Handbook.

We consulted on the draft methodologies in March 2019. This document sets out our methodology decisions following this consultation. We have published the consultation responses alongside this document.

# Contents

# Executive summary

The current price control for electricity distribution (RIIO-ED1) will end on 31 March 2023. Six elements will need addressing once the price control has ended; these are:

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

We have based the methodologies on the approach and principles we described in the RIIO-ED1 Strategy Decision. In relation to five of the elements, further development of the detail in line with those principles was required. The final element, relating to Shetland Extension costs, was introduced after the start of the price control. This relates only to Scottish and Southern Energy Power Distribution: Scottish Hydro Electric Power Distribution (SSEH). As with the other areas, further details were required to set out the arrangements needed to address variations from cost forecasts.

We received seven responses to the consultation, which we have carefully considered in making amendments to the methodologies.

This document provides a summary of each element of the price control, the way in which each methodology was developed, and an overview of the changes that we have made since the consultation. The detailed methodologies are provided in Appendix 1.

# 1. Background and Overview

## Background

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

1.2 Within RIIO-ED1 there are several cost areas that require specific mechanisms to account for their uncertain nature. These mechanisms mean some elements of the price control need to be settled (or "closed out") once the price control has ended and all the relevant information is available. These mechanisms include reopeners, which deal with over or underspend against allowances, and output mechanisms, which provide a reward or penalty for DNOs' delivery of outputs against target levels they were funded to deliver.

1.3 Table 1 gives a brief description of the areas of the price control that are subject to a closeout process.

**Table 1: Cost areas for closeout**

| Area | Description | Window(s) and direction |
|---|---|---|
| Load-related Expenditure Reopener | Costs associated with accommodating new and changing patterns of customers' electricity use (load related expenditure) above or below what was included in the price control settlement. | **2017** and **2020** – DNOs can trigger the mechanism up (to increase allowances) or down (to decrease allowances)<br>**2023** – Ofgem can trigger up or down |
| Net to Gross[1] | The difference between actual and forecast percentage of customer contributions to reinforcement work. DNOs are expected to explain the circumstances that led to a deviation from the expected range of Net to Gross ratios. | **2023** – Ofgem review the evidence provided by the DNOs (if applicable) and determine whether this justifies the final position; if it does, no adjustment to revenues will be made. |
| Network Asset Secondary Deliverables or Network Output Measures (NOMs) | DNOs have committed to delivering specific outputs relating to NOMs. | **2023** – Ofgem review of output delivery assessment, and revenue adjustment where DNOs have justified over delivery of outputs, or failed to deliver outputs. |
| High Value Projects (HVPs) | High-value schemes that were specified and agreed to be undertaken in RIIO-ED1. | **2019** – DNOs can trigger the mechanism for new HVPs only.<br>**2023** – Ofgem review of efficient expenditure, plus consideration of output delivery (interaction with NOMs).[2] Ofgem can trigger the mechanism up or down. |
| Link Boxes | The costs associated with mitigating the risk of disruptive failure of link boxes. For SPN and SPMW only. | **2017** – DNOs can seek additional funding<br>**2023** – Ofgem review of efficient expenditure |
| Shetland | The costs associated with managing an extension of services to meet electricity demand on Shetland, up to 2023. | **2017** – SSEH can seek additional funding<br>**2023** – Ofgem review of efficient expenditure |

[1] This only applies where no adjustment is being made under the Load Related Expenditure Reopener

[2] Where the driver for the HVP is either asset replacement or refurbishment

## Approach to RIIO-ED1 closeout

1.4 In March 2019, we consulted on our proposed methodologies that set out how each of these elements of the price control would be closed out.[1] These methodologies, once finalised, will form part of the Price Control Financial Handbook for RIIO-ED2.

1.5 In the March 2019 consultation, we noted that in developing these methodologies we used the approach taken to closing out the previous price control (DPCR5) as a starting point. We developed the methodologies in line with a number of RIIO-ED1 documents, including the Strategy Decision,[2] Final Determinations,[3] relevant licence conditions,[4] the Regulatory Instructions and Guidance (RIGs)[5], and the Financial handbook.[6]

1.6 Our overall intention was to establish a principles-based approach to the methodologies, maintaining consistency across the different areas as far as possible. This was in part as a result of our review of the RIIO-ED1 documents mentioned in paragraph 1.5, and in part as a result of learning from the approach taken at DPCR5 closeout.

1.7 In particular, we sought to establish a General Financial Adjustment Methodology that would apply to all areas of the price control that are subject to a closeout mechanism. This methodology ensures that any adjustments made as part of the closeout process are done on a consistent basis.

## Purpose of this document

1.8 This document sets out the background to the elements of the RIIO-ED1 price control that need to be closed out. It also provides a summary of the changes we have made to the methodologies following the consultation, with the finalised methodologies included in Appendix 1.

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[1] Consultation on RIIO-ED1 closeout methodologies
[2] RIIO-ED1 Strategy Decision - Overview
[3] RIIO-ED1 Final Determinations - Slow track
[4] RIIO-ED1 Special Licence Conditions
[5] RIIO-ED1 Regulatory Instructions and Guidance
[6] RIIO Financial Handbook

## General responses to the RIIO-ED1 closeout process

1.9 We received seven responses to our consultation; six were from network companies, and one was from a consumer body. All respondents gave comments on specific elements of the proposed methodologies. The six network companies all provided views on the overarching approach, as well as very specific comments (often accompanied by drafting suggestions).

1.10 A summary of the responses to the specific questions posed in the consultation is provided in the relevant chapters of this document, and we have published the responses on our website, alongside this decision.

## Your feedback

1.11 We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this report. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Are its conclusions balanced?
5. Any further comments?

Please send any general feedback comments to RIIO-ED1@ofgem.gov.uk.

# 2. Load Related Expenditure

**Section summary**

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

## Background to Load

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

2.2 The uncertainty around the potential investment that may be required warranted the inclusion of an uncertainty mechanism for RIIO-ED1. We therefore included a reopener (the load-related reopener, LRR) to protect both customers and DNOs from changes to investment requirements. This reopener allows for adjustments to allowed revenues for LRE.

**Load assessment**

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

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

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

2.5 The reopener allows for the recovery of efficient costs outside a deadband, provided that the costs are material. DNOs remain exposed to a proportion of any overspend incurred before the materiality threshold is reached. DNOs can trigger the reopener during two windows (as detailed in Table 1 of Chapter 1) if they can demonstrate that their efficient expenditure over RIIO-ED1 is, or will be, different to allowances by an amount greater than a deadband plus the materiality threshold.

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

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

*DPCR5 Closeout approach*

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

- Ofgem assessed DNOs’ efficient LRE and determined the difference between allowed expenditure and actual expenditure.
- Efficient expenditure was compared against the relevant thresholds; if these thresholds were exceeded, the reopener was triggered and Ofgem calculated and applied an adjustment to revenues. This adjustment was based on efficient expenditure, including any efficiencies delivered through innovative solutions.

- Ofgem ensured DNOs were not penalised twice under the LRR and the NOMs LI assessment, by offsetting any double counting between the two mechanisms.

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

## Summary of methodology

2.10 As set out in the consultation, we sought to use the DPCR5 approach as a basis for the approach for RIIO-ED1, building on and/or simplifying it where necessary. The approach was designed to follow a set of overarching principles, and was developed in alignment with the requirements of the associated licence conditions and the approach indicated in the ED1 Strategy Decision and Final Determinations.

2.11 A high-level summary of the proposed approach is provided below:

- Ofgem will evaluate a DNO's efficient level of LRE for RIIO-ED1, which will then be compared against that DNO's allowances for the same period. If Ofgem determine that any difference between these two values meets the criteria set out in licence condition CRC 3G (namely that the difference between actual expenditure and allowances is greater than 20% of the original allowances, and that the adjustment proposed by Ofgem constitutes a 'material amount'), then it will calculate the value of any adjustment that needs to be made.

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

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

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

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

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

## Net to Gross

2.13 As set out in the relevant licence conditions, Ofgem may assess whether DNOs have justified their final proportion of LRE that is funded by customers. DNOs will need to justify their final position in relation to the percentage that was defined at the start of the price control; if DNOs do not give adequate justification, Ofgem may revise a DNO's total level of LRE. This will only take place where no adjustment is made under the LRR, since any adjustment there will account for any differences (if applicable) in a DNO's overall Net to Gross position.

## Load Indices

2.14 As outlined in the consultation, the Load Indices (LIs) measure the utilisation of primary network substations, tracking trends in utilisation; they help determine when DNOs may need to intervene to ensure the long-term reliability of the network. The LIs tie a DNO's investment to the delivery of a particular level of utilisation at the end of the price control.

2.15 DNOs report the LI for each primary substation every year, meaning Ofgem can monitor how the overall LI risk points for each DNO's network changes over time as a result of changing utilisation of substations and/or reinforcement activities carried out by the DNO.

2.16 We chose not to set targets for LI delivery at the start of the price control due to the uncertainty around how they would interact with other parts of the price control. We outlined in the consultation that, given a number of factors continue to contribute to the level of network utilisation, setting targets for LIs in RIIO-ED1 would not provide a robust way to measure DNOs' performance in the price control. We therefore proposed to use LIs as part of the assessment of efficient LRE, rather than as a standalone closeout mechanism in their own right.

## Summary of respondents views

2.17 Seven respondents commented on our proposed methodology for assessing Load Related Expenditure. Broadly, respondents agreed with our proposed approach, noting that incrementally building on the DPCR5 methodology is a sensible way to develop the RIIO-ED1 policy. Some respondents suggested drafting changes, and others highlighted amendments that would need to be made to the licence to accommodate this methodology.

2.18 Six respondents agreed with our proposed approach to using LIs as part of the assessment of efficient LRE. A number of respondents noted potential clarifications that could be made around how LRE efficiency will be judged.

## Our views and decision

2.19 We note that all respondents broadly agreed with our proposed approach to assessing LRE, the DNOs' Net to Gross positions, and using LIs as part of the assessment of efficient LRE. We also note that some respondents proposed amendments to the drafting of the LRR methodology. We have, therefore, decided to proceed with the methodology as provided in Appendix 1. We provide a summary of the changes to the methodology in Chapter 7.

# 3. Network Asset Secondary Deliverables (NASD)

**Section summary**

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

## Background to NASD

3.1 One of the DNOs' key roles is to develop programmes of work to replace and refurbish assets to reduce their risk of failure and causing interruptions or other detrimental effects. We introduced the Network Asset Secondary Deliverables (NASD) to measure the reduction in risk delivered by the DNOs' work programmes, giving indications of the effectiveness of the investment the DNOs make. The NASD are leading indicators of network performance, and are closely linked with network expenditure.

3.2 Health and criticality indices, along with the associated calculation of monetised risk, are used to assess changes in the risk of the DNOs' networks over time. The Health Index (HI) is a composite measure of the age, condition, duty, and probability of failure for an asset. The criticality index measures the (financial) consequence of an asset failing and, when combined with the HI score, calculates a value of risk on each DNO's network.[7]

3.3 The DNOs forecast their asset health and criticality positions for the end of the price control, both with and without investment. These forecasts were used to set targets for improvement over the price control, against which we would measure progress on an aggregate basis (rather than on an asset-by-asset or asset-category basis). This aimed to give the DNOs flexibility in managing their assets and (re)prioritising

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

activities in the most appropriate way to deal with known and/or emerging issues on their network.

**NASD Assessment**

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

3.5 Licence condition CRC 5D builds on this approach, adding that DNOs must provide a report to Ofgem detailing their performance, and justifying any deviations (above or below) from the deadband target level. DNOs also need to provide any supporting analysis or information within specified timescales that will allow Ofgem to carry out their assessment. The licence condition also sets out that Ofgem can make an adjustment to RIIO-ED2 allowances and apply a penalty or reward rate where a DNO has not justified any under-delivery, or has justified over-delivery, respectively.

*DPCR5 Closeout approach*

3.6 An assessment of DNOs' delivery of secondary deliverables occurred as part of DPCR5 closeout. At a high level, the approach taken had two main stages:

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

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

3.7 As with LRR and High Value Projects, Ofgem's assessment followed a number of principles which were developed in accordance with the relevant price control documents, the RIGs, and outputs from ongoing work.

## Summary of methodology

3.8 As detailed in the consultation, we looked to build on the approach that was developed for closing out Network Output Measures in DPCR5, again building on and/or simplifying it where necessary. The approach was designed to follow a set of overarching principles and was developed in alignment with the requirements of the associated licence conditions, and the approach indicated in the ED1 Strategy Decision and Final Determinations.

3.9 A high-level summary of the proposed methodology is set out below:

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

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

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

## Summary of respondents views

3.10 Seven respondents commented on our proposed methodology for assessing NASD. Respondents broadly agreed with our proposed approach, supporting the development of the approach taken at DPCR5. A number of respondents highlighted that the deadband needs to be set as soon as possible to provide certainty to the overall mechanism, as well as seeking clarity on how the closeout adjustment will be profiled (based on actuals, allowances, or the difference between the two). Some respondents also provided suggested amendments to elements of the drafting.

## Our views and decision

3.11 As all respondents broadly agreed with our approach, we will implement the methodology as set out in the consultation, subject to some updates to reflect the comments and suggested changes provided in the responses. We have, therefore, decided to proceed with the methodology as provided in Appendix 1. We provide a summary of the changes we have made to the methodology in Chapter 7.

3.12 We note that a number of respondents sought clarity on when (and how) the deadband will be set. We believe this should be addressed separately from this decision, and have provided further detail in paragraph 1.7.13.

# 4. High Value Projects

**Section summary**

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

## Background to High Value Projects

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

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

### HVP Assessment

4.3 The RIIO-ED1 Strategy Decision set out that the DNOs' HVP reopener would cover new projects that were not known about when the price control was set, as well as projects that were known about but that were not included in baseline allowances.[8] It was also clear that where a DNO triggers the reopener within the price control, schemes will be reviewed on a project-by-project basis, through an assessment of whether total expenditure for that HVP meets a set of thresholds, and that no adjustments would be made on account of existing projects. The Authority's review after the end of the price control period also includes the same requirements for an

[8] These projects were not included in the baseline allowances because they failed to have one or more of clear outputs, forecast costs, and/or a needs case.

assessment of expenditure against thresholds; however unlike the within-period reopener, the Authority has the ability to make adjustments in respect of existing HVPs.

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

4.5 The Final Determinations for RIIO-ED1 note that there are secondary deliverables associated with HVPs. These cover a variety of different types of work, leading to a natural interaction with the NASDs. Any assessment of a DNO's performance against secondary deliverables for HVPs will only occur where the primary driver is either refurbishment or asset replacement. This assessment, along with any associated adjustments to allowances, will need to ensure there is no double-counting of over- or under-delivery through both the NASD and HVP assessments.

*DPCR5 Closeout approach*

4.6 HVPs were also assessed as part of the DPCR5 closeout process. The assessment of efficient costs under HVPs followed a number of principles, similar to those for LRR, that were developed in line with the DPCR5 Final Proposals, the RIGs, and the outputs from ongoing work on how to approach HVPs during DPCR5. The approach taken can be broadly summarised as:

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

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

## Summary of methodology

4.7 As with the other elements of RIIO-ED1 closeout, we used the DPCR5 approach as a basis for the RIIO-ED1 methodology, simplifying it and building on it (where necessary) to follow a set of overarching principles. The resulting methodology was developed in line with the requirements of the licence and the approach indicated in the ED1 Strategy Decision and Final Determinations.

4.8 A high-level summary of the proposed methodology is set out below:

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

- Where Ofgem finds that a failure to deliver against required outputs for non-load HVPs has occurred (as indicated by a failure in relation to NASD associated with a HVP), the related value will be netted off the adjustment that would be made, where costs are materially different from allowances.

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

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

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

## Summary of respondents views

4.10 All seven respondents provided comments on our proposed methodology for assessing High Value Projects. All respondents were, broadly, supportive of our proposed approach and agreed that building on the DPCR5 methodology is a sensible way to develop the policy. As with other areas, some respondents suggested drafting changes to the detailed methodology.

4.11 One respondent highlighted that the way the relevant licence conditions is drafted presents a circularity in relation to the total level of expenditure that should be used when assessing whether or not the reopener threshold is triggered. The respondent also noted that the current licence condition does not contain any procedures for the Authority to follow when making adjustments at the end of the price control.

4.12 Finally, one respondent sought encouragement from Ofgem that measures are in place to make sure DNOs do not sub-divide large projects into smaller items to avoid the £25m threshold.

## Our views and decision

4.13 As with other areas, we note that all respondents broadly agreed with our approach to assessing HVP costs, and we have therefore decided to implement the main principles behind the methodology. The methodology is, broadly, the same as the version that we consulted on, with some minor updates based on those suggested changes. We provide a summary of the changes we have made to the methodology in Chapter 7.

4.14 We note that some respondents highlighted important changes that need to be made to the relevant RIIO-ED1 licence conditions. We agree that these changes need to be made, and we will undertake a separate consultation on these proposals.

4.15 Finally, in relation to one respondent's request for clarity over the measures Ofgem will put in place to avoid DNOs' subdividing large projects, we note that the HVP mechanism is designed to provide additional allowances for these projects, provided they meet the relevant criteria. Any project that does not meet the relevant criteria (ie that costs less than £25m) will not be eligible for additional, discrete funding, and the overall costs of this would be subject to the Totex Incentive Mechanism. Therefore, if a DNO were to subdivide a project, they would bear a proportion of these costs rather than being provided with additional allowances. We believe this provides a robust framework for ensuring HVPs are assessed and delivered where they are in consumers' interests.

# 5. Link Boxes

**Section summary**

The uncertainty associated with providing funding for the DNOs to mitigate the risk of disruptive link box failures meant we need to be able to review volume delivery at the end of the price control. We clearly stated that this would happen as part of the closeout process, and have therefore developed this mechanism.

## Background to Link Boxes

5.1 We introduced an uncertainty mechanism for link boxes in RIIO-ED1, to address the costs of mitigating the risk of disruptive failures of link boxes. This became a high-profile issue following a number of incidents on some DNOs' networks.

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

5.3 Following our review of two DNOs' work in this area, we noted that we expected DNOs to deliver the volumes of work they proposed in their submissions and business plans.

**Link box reopener**

5.4 As noted, one of the uncertainty mechanisms in RIIO-ED1 was to cover DNOs' costs in effectively managing the risk associated with link boxes. We provided a reopener window in 2017 for either DNOs or Ofgem to propose adjustments to allowances for link boxes. In our decision for that window we noted our intention to review DNOs' delivery of their proposed volumes as part of the RIIO-ED1 closeout process.

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

## Summary of methodology

5.6 Since link boxes did not form part of the DPCR5 closeout process, there was no previous approach that could be used as a basis. However, the mechanism has a number of similarities to the general approach that was taken for other elements in DPCR5, and we used these elements as a basis for our methodology. As with other mechanisms in RIIO-ED1 closeout, we have built on the general DPCR5 approach and simplified it where possible, so as to follow a number of overarching principles. We also developed the link boxes methodology in line with the requirements of the licence, and reflected the approach to assessing volume delivery that was signalled in the decision for the 2017 reopener.

5.7 As in other areas, Ofgem's assessment of volume delivery will cover the total volumes delivered. A high-level summary of the proposed methodology is set out below:

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

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

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

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

## Summary of respondents views

5.8 Six respondents provided comments on our proposed methodology for Link Boxes. All respondents were generally supportive of our proposed approach. One respondent noted that the unit costs provided in Table X.2 were not reflective of the unit costs used to set allowances for one licensee, and the respondent recommended Ofgem use separate values for the two DNOs that are subject to this mechanism.

## Our views and decision

5.9 Those respondents who provided comments agreed with our proposed approach overall. We agree that there should be separate unit costs for the two DNOs that are subject to this mechanism, and have included these in the updated methodology. This is the only change that we have made to the methodology.

# 6. Shetland

**Section summary**

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

## Background to Shetland

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

6.2 Scottish Hydro Electric Power Distribution (SHEPD) ran a competitive process to find the best solution for ensuring security of supply on the islands. The preferred bid was a distribution link between the islands and the mainland, with a back-up diesel power station, for which we published a minded-to consultation approving these costs.[9]

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

[9] Consultation on Shetland New Energy Solution

Aid approval, be eligible to compete for Contract for Difference in the auction in 2019.

6.4 SHEPD investigated the options available as a result of these developments and confirmed that security of supply can be provided until 2025, through a combination of LPS and supporting measures at a significantly lower cost than the original solution.[10]

**Shetland reopeners**

6.5 While the steps outlined above produced an interim solution, there was still sufficient uncertainty around the costs forecast out to 2023. We therefore introduced uncertainty mechanisms to cover three cost categories. The first is referred to as the Shetland Extension Fixed Energy Costs (SEFEC). A sub-component of these costs relate to the costs associated with providing a battery, as part of the interim solution; this set of costs are known as the Shetland Extension Battery Costs (SEBC). The third cost category covers costs known as the Shetland Enduring Solution Process Costs (SESPC). These costs are all defined in CRC 3F.

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

## Summary of methodology

6.7 Although there was no DPCR5-related precedent for Shetland, as with Link boxes there are a number of similarities to the general approach to re-openers that was taken in DPCR5. We have, therefore, used the general approach adopted in DPCR5 and in other RIIO-ED1 closeout mechanisms as a basis for Shetland, adjusting it where necessary. We have developed this in line with the overarching principles

[10] Decision on Shetland New Energy Solution

applied in other areas of RIIO-ED1 closeout, ensuring consistency with the licence requirements and relevant price control documentation.

6.8 As with other areas, Ofgem's assessment of costs will cover the expenditure for these cost categories over the whole of RIIO-ED1. A high-level summary of the proposed methodology is set out below:

- Either Ofgem or SHEPD may propose an adjustment to one or more of the three cost categories during windows after the end of the ED1 period, as specified in CRC 3F.
- Ofgem will check whether the costs that have been incurred represent efficient expenditure, and whether any further information is needed to make a decision. Where SHEPD provides notice of a proposed adjustment, Ofgem will check that the relevant notice has been provided during the specified window.
- Using the relevant notice, Ofgem will check whether the overall materiality threshold has been passed, before deciding whether to confirm or amend the adjustment, or if it proposes an adjustment based on an assessment of costs incurred, Ofgem will consult on that proposal before deciding what adjustment to make.
- This adjustment will then be spread across each year of RIIO-ED1, mirroring the timing profile of the original allowances, and have Time Value of Money adjustments applied.
- This resulting value will then be divided into two portions – one to adjust the DNO's RAV, and one to adjust the DNO's RIIO-ED2 revenue. Any adjustments to the DNO's RIIO-ED2 revenue on account of 'catch up' for RIIO-ED1 revenues will be spread equally across the five years of RIIO-ED2.

## Summary of respondents views

6.9 Six respondents provided comments on the proposed methodology for Shetland. All were in support of the proposed approach, and one respondent suggested a few minor drafting changes to the detailed methodology.

## Our views and decision

6.10 As with other areas, we note that all respondents broadly agreed with our approach to assessing Shetland costs, and we have therefore decided to implement the methodology. We have made some minor drafting changes to reflect those points raised in the responses. We provide a summary of the changes we have made to the methodology in Chapter 7.

# 7. Changes since consultation

**Section summary**

We have reviewed the responses to the consultation, and made a number of changes to the methodologies to reflect the points raised. This chapter gives a summary of the changes that we have made to each element of the methodologies.

## Summary

7.1 This section provides a broad overview of the changes that have been made to the methodologies since the consultation. These reflect comments that were provided in the responses to the consultation, as well as further amendments that we have made to provide additional clarity on the approach that should be taken.

7.2 The drafting changes can be broken down into three main categories. First, we have made a number of grammatical, reference, or wider consistency changes. These do not materially affect the intent of the methodologies. Second, we have revised elements of the drafting in response to comments provided in response to the consultation. And third, we have made further amendments we consider necessary to either refine/clarify the approach, or to better reflect our interpretation of the rules laid out in the licence.

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

7.3 We have included an overarching statement that sets out the purpose of this section of the handbook. This text also makes it clear that all calculations are to be made with reference to the same price base.

*Section 1: Load Related Reopener*

7.4 In addition to drafting edits (such as ensuring we refer to terms in a consistent manner), we have also clarified the way in which terms should be interpreted. To do this, we have set out that defined terms should be read in line with the definition given in the licence and the RIIO-ED1 Financial Handbook.

*Section 2: Net to gross adjustment*

7.5 The main change we have made is to bring this section in line with the Load Related Reopener section. Other changes are predominantly drafting edits.

*Section 3: Network Asset Secondary Deliverables*

7.6 Under this section, we have removed a number of steps that were part of the approach the Authority will take in applying a penalty or reward. This is to avoid duplication with later parts of the methodology. As with the other sections, we have tidied up the drafting to ensure it is clear.

*Section 4: High Value Project Costs*

7.7 In addition to drafting changes, we have added in a paragraph to clarify that the Authority will give Notice of any proposed determinations and will allow the licensee to make representations to this, which the Authority will consider. We believe that adding this paragraph avoids any doubt about whether this would take place.

*Section 5: Link Box Replacement*

7.8 We have updated the unit costs associated with the adjustments for link boxes, reflecting the fact that different unit costs should be used for the different licensees. We have also added in details to clarify when the Authority will make an adjustment to allowed expenditure.

*Sections 6 to 8: Shetland Extension Fixed Energy Costs, Shetland Extension Battery Costs, and Shetland Enduring Solution Process Costs*

7.9 We have not made any major changes to these sections, beyond drafting edits to provide clarity and consistency with other sections.

**Annex A: Load Related Re-opener Closeout Methodology**

7.10 The majority of the changes to this section are to simplify and clarify the drafting. We have defined terms in reference to the RIIO-ED1 licence, and ensured a consistent approach for referring to the RIIO-ED1 and RIIO-ED2 price controls, and other relevant terms (ie Load Related Expenditure).

7.11 We have moved one paragraph from Step 3 to Step 2, and streamlined the drafting. Finally, we have also ensured there is clarity on how any adjustments to efficient expenditure will be made to account for efficiencies generated through innovation.

**Annex B: ED1 Net to Gross Assessment Methodology**

7.12 We have not made any major changes to this section, beyond drafting edits to provide clarity and consistency with other sections.

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

7.13 We have not made any major changes to this section, beyond drafting edits to provide clarity and consistency with other sections. A number of responses to the consultation sought clarity over when the deadband around the performance targets will be set. As set out in the Decision on the Network Output Measures Incentive Methodology,[11] we consider that a decision on the level of the materiality threshold should be left open at this stage, until we have a better understanding of the data that will support performance against NASD outputs. This will ensure that we protect both consumers and DNOs.

7.14 We have also added clarity on how performance will be treated if the licensee exactly meets the materiality threshold.

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

7.15 We have condensed the steps that the Authority will follow in determining the licensee's HVP Costs, and clarified some elements of the steps (such as the evidence that the Authority will include in its analysis). We have also removed the final step as in the consultation (Step 5), as the content in this step is repeated in Annex E.

[11] Decision on Network Output Measures incentive methodology

**Annex E: General Financial Adjustment Methodology**

7.16 In addition to general drafting edits to give extra clarity and/or consistency, we have made some changes to this Annex. We have streamlined the first step to refer to the relevant sections of the main handbook chapter that accompanies this annex. We have also removed portions of the text that outline the timing profile for the adjustments, and included an additional column in Table E1 to provide this information.

**Annex F: Performance Assessment Submission**

7.17 To streamline this annex, we have added a table in to set out the relevant submission deadlines for each aspect of closeout. This is in addition to general edits to simplify and clarify the text.

# Appendix 1: RIIO-ED2 Price Control Financial Handbook text

## 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 CRC 3G, CRC 3F, CRC 5D, and CRC 5G to adjust ED1 Price Control Period expenditure allowances after the end of the ED1 Price Control Period.

Except where otherwise stated, all calculations under this section of the financial handbook are to be made with reference to 2012/13 prices using the ED1 Price Control Period price base.

### Section 1: ED1 Load Related Re-opener - adjustment resulting from revised allowance levels upon Authority trigger

#### Overview

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

X.2 This section sets out the financial methodology the Authority will follow in determining any revisions to the licensee's opening RAV balance and Base Demand Revenue for the Next Price Control Period under CRC 3G.20 of the ED1 Licence. In this section defined terms have the meaning given to them in the latest version of CRC.3G of the ED1 Licence and of the ED1 Financial Handbook.

#### Calculation of ED1 Price Control Period Load Related Re-opener adjustment

X.3 CRC 3G.7 and 3G.10 require the Authority to evaluate an efficient value of TLRRCF for the regulatory years 2015/16 to 2022/23 (which is defined in CRC 3G.6(a) 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 is defined in CRC 3G.3.

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 (i) be in accordance with CRC 3G.24, (ii) specify revised values for the licensee's opening RAV balance and Base Demand Revenue, and (iii) 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 allow the licensee at least 28 days from the date of that provisional determination in which to respond.

## Section 2: Net to gross adjustment for Price Control Period Load Related Expenditure

X.7 CRC 5G sets out a mechanism for revising the licensee's allowed 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.13 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 Next Price Control Period under CRC 5G.14. In this section, defined terms have the meaning given to them in the latest version of CRC 5G of the ED1 Licence and of the ED1 Financial Handbook.

### Calculation of ED1 Net to Gross 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 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 set out at Annex B: 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 Next Price Control Period. The Authority will follow the methodology set out in Annex E: General Financial Adjustment Methodology in order to calculate that value.

## Section 3: 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 under CRC 5D to the licensee's opening RAV balance and Base Demand Revenue for the Next Price Control Period in respect of the licensee's delivery of Network Asset Secondary Deliverables (NASD) in the ED1 Price Control Period.

X.12 The Authority will follow the methodology for assessing delivery of NASD in the ED1 Price Control Period set out in Annex C: 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 Price Control Period, and (ii) set out, in accordance with CRC 5D.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). The Authority will follow the methodology set out in Annex E: General Financial Adjustment Methodology to calculate those values.

X.14 If, under Annex C: ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology, the Authority determines that a NASD Allowance Adjustment Value is required in respect of the ED1 Price Control Period, the Authority will (i) determine the ED1 NASD Allowance Adjustment Value in accordance with Stage 7, as set out in Annex C: ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology, and (ii) follow the steps E.1 (b) to (i) as set out in Annex E: General Financial Adjustment Methodology in order to calculate those values.

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

(a) Determine the NASD Allowance Adjustment Value for the ED1 Price Control Period in accordance with stage 7 as set out in Annex C: ED1 Network Asset Secondary Deliverables (NASD) Closeout Methodology;

(b) Multiply the value obtained in step X.15(a) by 2.5 and divide by 100 to determine the reward or penalty value.

**Determination of the ED1 Price Control Period NASD allowed revenue and RAV adjustment values**

X.16 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 The Authority will not determine a NASD adjustment for the ED1 Price Control Period for the purpose of determining revised Next Price Control Period PCFM values before 30 November 2023.

X.18 The Authority will use the methodology set out in Section 3 to determine any NASD Adjustment in respect of the ED1 Price Control Period for the licensee by 30 November 2024.

X.19 The Authority will not determine any further NASD adjustments in respect of the ED1 Price Control Period for the licensee after 30 November 2024.

## Section 4: Price Control Period High Value Project Costs (HVP) adjustments

### Overview

X.20 CRC 3F sets out the mechanism for the proposal and determination of relevant adjustments to the licensee's opening level of High Value Project Costs upwards or downwards for the ED1 Price Control Period.

X.21 This section sets out the financial methodology the Authority will follow in determining a relevant adjustment to the licensee's allowed expenditure for High Value Project Costs following any proposal it makes under CRC 3F.8,[12] after the end of the 2022/23 regulatory year.

[12] For licensees EPN, LPN and SPN. Equivalent CRC 3F paragraph for SSEH is 3F.23

**HVP Re-opener adjustment**

X.22 Paragraph 3F.11[13] of CRC 3F specifies the window for the Authority to give Notice of its proposal to make a relevant adjustment in respect of High Value Project Costs. Appendix 1 of CRC 3F sets out the tests to be applied to any relevant adjustment the Authority proposes in relation to High Value Project Costs, as well as the relevant material amount for the licensee.

**Calculation of RIIO-ED1 HVP Re-opener adjustment**

X.23 CRC 3F.8, CRC 3F.9,[14] and Appendix 1 of CRC 3F allow the Authority to determine an adjustment to the allowed level of High Value Project Costs. Under Appendix 1 of CRC 3F, the value of TUCHVPF is used for comparison with the total opening level of allowed expenditure (TUCHVPov), which are both defined under Appendix 1 of CRC 3F. The Authority will follow the methodology for evaluating TUCHVPF set out in Annex D: High Value Projects Closeout Methodology.

X.24 If the Authority makes a determination under CRC 3F,[15] that determination must specify the revised total level of allowed High Value Project Costs. The Authority will follow the methodology set out in Annex E: General Financial Adjustment Methodology in order to calculate the consequential revisions to the opening RAV balance and Base Demand Revenues for the Next Price Control Period.

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

X.25 The Authority will give Notice to the licensee (and any other interested parties) of the proposed determination in accordance with CRC 3F.23, and will allow the licensee to make representations about the proposed determination, which the Authority will consider.

X.26 The Authority will use the revised expenditure allowance amounts, as calculated using the methodology set out in Annex E: General Financial Adjustment Methodology, to determine the High Value Project Re-opener adjustment values for the Price Control Period for the licensee by 30 November 2024, for the purpose of determining revised PCFM values for the Next Price Control Period.

[13] EPN, LPN, SPN: 3F.12. SSEH: 3F.24
[14] EPN, LPN, SPN: 3F.8 AND 3F.10. SSEH: 3F.31 and 3F.32
[15] EPN, LPN, SPN: 3F.22. SSEH: 3F.29

X.27 The Authority will not determine any further revisions to the High Value Project Costs Re-opener adjustment values in respect of the ED1 Price Control Period for the licensee after 30 November 2024 for the purpose of determining revised PCFM values for the Next Price Control Period, but this shall be without prejudice to any requirement for the licensee to restate the values referred to in paragraph X.24 for any other purpose.

## Section 5: ED1 Link Box Replacement adjustments (SPN and SPMW only)

X.28 The link box-related uncertainty mechanism in CRC 3F provides for relevant adjustments in respect of the difference between Actual RIIO-ED1 Link Box Replacement Volumes and Allowed RIIO-ED1 Link Box Replacement Volumes. This mechanism applies to SPN and SPMW only.

### The uncertainty mechanism for RIIO-ED1 Link Box Costs

X.29 By 31 July 2023, the licensee must provide the Authority with a Performance Assessment Submission outlining the approach that it has adopted to manage the asset risk associated with Link Boxes and confirming its Actual RIIO-ED1 Link Box Replacement Volumes as compared to its Allowed RIIO-ED1 Link Box Replacement Volumes, and its associated costs.

X.30 The Authority will, by 30 November 2023, take the steps set out below to determine whether an adjustment to the costs associated with delivering its Allowed RIIO-ED1 Link Box Replacement Volumes should be made:

(a) The Authority will check whether it requires any further information, analysis or reformatting from the licensee in order to make a determination and, if it decides that further information is required it will give Notice of that requirement to the licensee within 10 working days of receipt of confirmation of the licensee’s Actual RIIO-ED1 Link Box Replacement Volumes. It should be noted that the issuing of a Notice as described above does not preclude the Authority from making further requests for information, analysis and reformatting. The licensee will have a minimum of 5 working days to reply to all requests for further information, analysis or reformatting.

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

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

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

(c) Having carried out steps (a) and (b) above and having considered the licensee’s response to any requests by the Authority for further information, analysis or reformatting, the Authority will determine whether the licensee has or has not delivered its Allowed RIIO-ED1 Link Box Replacement volumes.

(d) If Actual RIIO-ED1 Link Box Replacement Volumes - Allowed RIIO-ED1 Link Box Replacement Volumes is <0, so that the Licensee has not delivered its Allowed RIIO-ED1 Link Box Replacement Volumes, the Authority will, subject to X.34, make a provisional determination as to whether an adjustment to allowed expenditure should be made.

(e) If Actual RIIO-ED1 Link Box Replacement Volumes – Allowed RIIO-ED1 Link Box Replacement Volumes ≥ 0, so that the Licensee has delivered its Allowed RIIO-ED1 Link Box Replacement Volumes, no adjustment to allowed expenditure will be made.

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

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

| Licensee | Unit cost (12/13 prices) |
|---|---|
| SPN | £4,537 |
| SPMW | £5,700 |

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

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

**Link Box Closeout materiality threshold**

X.34 A Link Box Closeout Materiality Threshold applies to any proposed adjustment. The materiality threshold for the licensee, in 2012/13 prices, is specified in Table X.3 of this subsection. If the proposed adjustment does not exceed this threshold, then no adjustment will be made.

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

| Materiality Threshold |
|---|
| 0.2 |

**Determination of a relevant adjustment**

X.35 The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond. A determination by the Authority will specify:

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

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

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

X.37 The Authority will factor any adjustments into its determination of the UCLB values for the licensee by 30 November 2023, for the purpose of determining the value of revised PCFM values.

X.38 Subject to paragraph X.36, no further revisions to the UCLB values for the licensee will be determined after 30 November 2023 for the purpose of determining revised RIIO-ED2 PCFM values.

## Section 6: ED1 Shetland Extension Fixed Energy Costs and Shetland Extension Battery Costs Adjustments (SSEH only)

### Overview

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

X.40 This 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 Next Price Control Period under CRC 3F.15, CRC 3F.22, or CRC 3F.26, after the end of Regulatory Year 2022/23. In this section, defined terms have the meaning given to them in the latest version of the ED1 licence condition and of the ED1 Financial Handbook.

X.41 The term UCSEFEC means costs incurred, or expected to be incurred by SSEH in managing an extension of services to meet electricity demand on Shetland to 2023, to the extent that those costs are not otherwise recoverable under the Charge Restriction Conditions of the ED1 licence. The term UCSEBC means a sub-component of those costs specifically in relation to the costs associated with providing a battery as part of the interim solution. These definitions are set out in CRC 3F.38.

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

(a) efficient costs that were not included in the calculation of Opening Base Revenue Allowances for SSEH;

(b) efficient costs that are not subject to pass-through provisions in CRC 2B; and

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

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

**The uncertainty mechanism for Shetland Extension Fixed Energy Costs**

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

X.43 If the Authority receives Notice of a proposed relevant adjustment from the licensee, in respect of Shetland Extension Fixed Energy Costs it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended:

(a) The Authority will check whether the Notice has been received during the window referred to in paragraph X.39. If the Notice has been received before 1 September 2023, the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during September 2023. If the Notice has been received after 30 September 2023, the Authority will notify the licensee that the Notice has been received too late and that a relevant adjustment will not be determined.

(b) The Authority will check whether:

i. each of the requirements set out in paragraphs 3F.31 and 3F.32 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (d)); and

ii. costs that have been incurred represent a necessary and efficient level of expenditure.

(c) The Authority will decide whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required it will give Notice of that requirement to the licensee as specified in paragraph 3F.16 of CRC 3F, within 10 working days of receipt of a proposal under paragraph CRC 3F.12 of CRC 3F.

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

(d) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs X.55, X.57 and X.58. If it has not been passed, then no relevant adjustment will be made.

(e) Having carried out steps (a) to (d) above, in the case of a proposal from the licensee, the Authority will provisionally determine whether to:

i. reject the relevant adjustment proposed by the licensee;

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

iii. amend the relevant adjustment proposed by the licensee.

X.44 If the Authority decides to confirm or amend the licensee’s proposal it will provisionally determine the adjustments to allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied, having regard to paragraph X.42.

X.45 If the Authority decides to reject the licensee’s proposal it will provisionally determine that no adjustments to allowed expenditure should be made. The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond. The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

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

X.46 The Authority will assess the licensee’s level of Shetland Extension Fixed Energy Costs prior to the window set out in paragraph CRC 3F.25, and will use this assessment to inform its decision on whether or not to give Notice under CRC 3F.23. In undertaking this assessment, the Authority will consider whether the licensee’s Actual Shetland Extension

Fixed Energy Costs are materially different (as per the materiality threshold specified in X.55) from the total Shetland Extension Fixed Energy Costs allowance value, based on the information available to the Authority at the time. This information will include, but not be limited to, ED1 RIGs submissions and any other relevant submissions made by the licensee during or after the ED1 Price Control Period.

X.47 Any proposal made by the Authority must comply with the requirements of CRC 3F.31 and CRC 3F.32. The Authority will apportion any proposed adjustment to Regulatory Years 2019/20 to 2022/23 in line with the timing profile of the licensee's UCSEFEC values.

X.48 On giving Notice of a proposed relevant adjustment, the Authority will follow the steps set out in CRC 3F.28, and will then make a relevant adjustment determination.

**The uncertainty mechanism for the Shetland Extension Battery Costs**

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

X.49 Once the Authority receives Notice of a proposed relevant adjustment by the licensee and a complete record of the licensee's Shetland Extension Battery Costs, it will take the steps set out below to determine whether the proposed adjustment should be made:

(a) The Authority will check whether the Notice has been received during the window referred to in paragraph X.39. If the Notice has been received before 1 July 2023, the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during July 2023. If the Notice has been received after 31 July 2023, the Authority will notify the licensee that the Notice has been received too late and that a relevant adjustment will not be determined.

(b) The Authority will check whether:

i. each of the requirements set out in paragraphs 3F.31 and 3F.32 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (d)); and

ii. costs that have been incurred represent a necessary and efficient level of expenditure.

(c) The Authority will check whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required it will give Notice of that requirement to the licensee as specified under paragraph 3F.16 of CRC 3F, within 10 working days of a receipt of a proposal under paragraph CRC 3F.13.

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

(d) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs X.56 to X.58 for the proposed relevant adjustments for Shetland Extension Battery Costs. If it has not, then no relevant adjustment will be made.

(e) Having carried out steps (a) to (d) above, the Authority will provisionally determine whether:

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

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

X.50 If the Authority determines the Shetland Extension Battery Costs have not been spent, or that the licensee has spent its Shetland Extension Battery costs and the materiality threshold has been passed, and it decides to confirm or amend the licensee's proposal, it will provisionally determine the adjustments to the licensee's allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied, having regard to paragraph X.42.

X.51 The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond. The Authority will consider any consultation responses from the licensee and other respondents and will then make a relevant adjustment determination.

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

X.52 The Authority will assess the licensee's level of Shetland Extension Battery Costs prior to the window set out in paragraph CRC 3F.23, and will use this assessment to inform its decision on whether or not to give Notice under CRC 3F.25. In undertaking this assessment, the Authority will consider whether the licensee's Actual Shetland Extension Battery Costs are lower than the total Shetland Extension Battery Costs allowance value for the Regulatory Years 2019/20 to 2022/23, based on the information available to the Authority at the time. This information will include, but not be limited to, ED1 RIGs submissions, the complete record of Shetland Extension Battery Costs, and any other relevant submissions made by the licensee during or after the ED1 Price Control Period.

X.53 Any proposal made by the Authority must comply with the requirements of CRC 3F.31 and CRC 3F.32. The Authority will apportion any proposed adjustment to Regulatory Years 2019/20 to 2022/23 in line with the timing profile of the licensee's UCSEBC values.

X.54 On giving Notice of a proposed relevant adjustment, the Authority will follow the steps set out in CRC 3F.28, and will then make a relevant adjustment determination.

**Overall materiality threshold**

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

X.55 An overall materiality threshold applies in respect of relevant adjustments for the Shetland Extension Fixed Energy Costs, whether proposed by the licensee or the Authority. The materiality threshold for the licensee, in 2012/13 prices, is specified in Appendix 9 to CRC 3F.

X.56 An overall materiality threshold applies in respect of relevant adjustments for the Shetland Extension Battery Costs, where proposed by the licensee but only where the expenditure is materially higher than expected levels of actual expenditure. The materiality threshold for the licensee, in 2012/13 prices, is specified in Appendix 11 to CRC 3F. For UCSEBC, the materiality threshold for any downward adjustment is zero.

X.57 If the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, the materiality threshold is not further taken into account in the determination of relevant adjustments to allowed expenditure levels. This applies to the respective proposed adjustment and materiality threshold for both UCSEFEC and UCSEBC.

X.58 If the proposed relevant adjustment (in 2012/13 prices) is, in total, less than the materiality threshold amount, then no adjustment will be made. However, in that case, the costs will be subject to the Totex Incentive Mechanism. This applies to the respective proposed adjustment and materiality threshold for both UCSEFEC and UCSEBC. For UCSEBC, the materiality threshold for any downward adjustment is zero.

**Determination of a relevant adjustment**

X.59 A determination by the Authority that makes a relevant adjustment in respect of Shetland Extension Fixed Energy Costs and/or Shetland Extension Battery Costs will specify:

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

(b) the revised total amounts of allowed Totex expenditure (in 2012/13 prices) for each of those Regulatory Years.

X.60 If the Authority does not make a relevant adjustment determination within four months of the close of the application window, then paragraph 3F.22 of CRC 3F stipulates that the adjustment will be deemed to have been made.

X.61 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSEFEC and / or UCSEBC values under paragraph X.78 of this section.

## Section 7: ED1 Shetland Enduring Solution Process Costs adjustments (SSEH only)

**Overview**

X.62 CRC 3F sets out a mechanism for revising SSEH's allowed level of Shetland Enduring Solution Process Costs (UCSESPC) expenditure at the end of the ED1 Price Control period. CRC 3F.12 provides the application window for the licensee to propose adjustments in respect of UCSESPC. CRC 3F.25 provides a window for the Authority to give the licensee Notice of its intention to make an adjustment to UCSESPC.

X.63 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 Next Price Control Period under CRC 3F.15, CRC 3F.22, or CRC 3F.26, after the end of Regulatory Year 2022/23. In this section, defined terms have the meaning given to them in the latest version of the ED1 licence condition and of the ED1 Financial Handbook.

X.64 The term UCSESPC means costs incurred, or expected to be incurred by SSEH for identifying and procuring an enduring solution for Shetland, in implementing its obligations under CRC 2Q and further to the competitive process referred to in the Authority's open letter entitled "Ofgem's determination of Scottish Hydro Electric Power Distribution plc's (SHEPD) submission required under Charge Restriction Condition (CRC) 18A" dated 22 April 2014, to the extent that those costs are not otherwise recoverable under the Charge Restriction Conditions of the ED1 licence. This definition is set out in CRC 3F.38.

X.65 This uncertainty mechanism provides for relevant adjustments to levels of allowed expenditure for Regulatory Year 2019/20 to Regulatory Year 2022/23 in respect of:

(a) efficient costs that were not included in the calculation of Opening Base Revenue Allowances for SSEH (with respect to proposals made by SSEH); and

(b) materially lower than expected levels of actual expenditure (with respect to proposals made by the Authority).

**The uncertainty mechanism for Shetland Enduring Solution Process Costs**

*Determination of a relevant adjustment proposed by the licensee*

X.66 If the Authority receives Notice of a proposed relevant adjustment from the licensee, in respect of Shetland Enduring Solution Process Costs it will take the steps set out below to determine whether the proposed adjustment should be confirmed, rejected or amended:

(a) In the case of a proposal from the licensee, the Authority will check whether the Notice has been received during the window referred to in CRC 3F.25. If the Notice has been received before 1 September 2023 the Authority will notify the licensee that the Notice has been submitted too early and should be resubmitted during September 2023. If the Notice has been received after 30 September 2023 the Authority will notify the licensee that the Notice has been received too late and that a relevant adjustment will not be determined.

(b) The Authority will check whether:

i. each of the requirements set out in paragraphs 3F.27 and 3F.28 of CRC 3F has been met (except for the requirement in respect of a material amount – see step (d)); and

ii. costs that have been incurred, represent a necessary and efficient level of expenditure.

iii. The Authority will decide whether it requires any further information from the licensee in order to make a determination and, if it decides that further information is required it will give Notice of that requirement to the licensee as specified in paragraph CRC 3F.16, within 10 working days of receipt of a proposal under paragraph CRC 3F.12.

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

(c) The Authority will check whether the overall materiality threshold has been passed in accordance with paragraphs X.72 to X.74. If it has not been passed, then no relevant adjustment will be made.

(d) Having carried out steps (a) to (c) above, the Authority will provisionally determine whether to:

i. reject the relevant adjustment proposed by the licensee;

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

iii. amend the relevant adjustment proposed by the licensee.

X.67 If the Authority decides to amend or confirm the licensee's proposal it will provisionally determine the adjustments to allowed expenditure that should be made and the Regulatory Years to which those adjustments should be applied, having regard to paragraph X.65.

X.68 If the Authority decides to reject the licensee's proposal it will provisionally determine that no adjustments to allowed expenditure should be made. The Authority will consult the licensee on its provisional determination, allowing the licensee at least 28 days in which to respond. The Authority will consider any consultation responses from the licensee and will then make a relevant adjustment determination.

*Determination of a relevant adjustment proposed by the Authority*

X.69 The Authority will assess the licensee's level of Shetland Enduring Solution Process Costs prior to the window set out in CRC 3F.25, and will use this assessment to inform its decision on whether or not to give Notice under CRC 3F.23. This notice must be given during September 2023. In undertaking this assessment, the Authority will consider whether the licensee's actual Shetland Enduring Solution Process Costs are materially different (as per the materiality threshold specified in X.72) from the total Shetland Enduring Solution Process Costs allowance value, based on the information available to the Authority at the time. This information will include, but not be limited to, ED1 RIGs submissions and any other relevant submissions made by the licensee during or after the ED1 Price Control Period.

X.70 Any proposal made by the Authority must comply with the requirements of CRC 3F.31 and CRC 3F.32. The Authority will apportion any proposed adjustment to Regulatory Years 2019/20 to 2022/23 in line with the timing profile of the licensee's UCSESPC values.

X.71 On giving Notice of a proposed relevant adjustment, the Authority will follow the steps set out in CRC 3F.28, and will then make a relevant adjustment determination.

**Overall materiality threshold**

X.72 An overall materiality threshold applies in respect of relevant adjustments for Shetland Enduring Solution Process Costs, whether proposed by the licensee or the Authority. The materiality threshold for the licensee, in 2012/13 prices, is specified in the table in Appendix 10 to CRC 3F.

X.73 If the proposed relevant adjustment (in 2012/13 prices) is, in total, more than the materiality threshold amount, the materiality threshold is not further taken into account in the determination of relevant adjustments to allowed expenditure levels.

X.74 If the proposed relevant adjustment (in 2012/13 prices) is, in total, less than the materiality threshold amount, then no adjustment will be made. However, in that case, the costs will be subject to the Totex Incentive Mechanism.

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

X.75 A determination by the Authority that confirms or amends a relevant adjustment proposed by the licensee in respect of Shetland Enduring Solution Process Costs will specify:

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

(b) the revised total amounts of allowed Totex expenditure (in 2012/13 prices) for each of those Regulatory Years.

X.76 If the Authority receives Notice of a proposed relevant adjustment from the licensee in respect of Shetland Enduring Solution Process Costs and does not make a relevant adjustment determination within four months of the close of the application window, and the proposal has not been withdrawn, then paragraph 3F.22 of CRC 3F stipulates that the adjustment will be deemed to have been made.

X.77 The Authority will apply any relevant adjustment determined or deemed to have been made in the determination of revised UCSESPC values under section X.78 of this section.

## Section 8: Calculation of revenue adjustments for Shetland Extension Fixed Energy Costs, Shetland Extension Battery Costs, and Shetland Enduring Solution Process Costs Re-openers

X.78 CRC 3F.12, CRC 3F.13 and CRC 3F.23 allow the licensee and the Authority to propose relevant adjustments for Shetland Extension Fixed Energy Costs (UCSEFEC values), Shetland Extension Battery Costs (UCSEBC values), and Shetland Enduring Solution Process Costs (UCSESPC values)

X.79 If the Authority determines one or more relevant adjustments for Shetland Extension Fixed Energy Costs, Shetland Extension Battery Costs, or Shetland Enduring Solution Process Costs under CRC 3F.15 or CRC 3F.26, or an adjustment is deemed to have been made under CRC 3F.22, the Authority must specify revised values for the licensee's opening RAV balance and base demand revenue for the Next Price Control Period, and the years to which the determination(s) apply.

X.80 The Authority will undertake the steps given in paragraph E.1 of Annex E to calculate these values.

# Annex A: ED1 Load Related Re-opener Closeout Methodology

**Overview**

A.1 This Annex sets out how the Authority will assess the licensee's total level of efficient Load Related Expenditure over the ED1 Price Control Period (TLRRCF, as defined in CRC 3G.7) for the purpose of making a determination under CRC 3G.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 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 efficient Load Related Expenditure prior to the window specified in CRC 3G.16, and will use 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, the Authority will consider the licensee's allowed and actual Load Related Expenditure 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 (including, but not limited to, submissions made in accordance with RIGs 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, including where those results indicate that a reopener is not necessary and, therefore, that the Authority need not give the licensee a Notice under CRC 3G.6. Where the Authority does give a Notice in accordance with CRC 3G.16, 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 the Performance Assessment Submission described in Step 2.

**Step 2: Performance Assessment Submission**

A.6 Where the licensee is required to submit further information or analysis in relation to a Notice given by the Authority under CRC 3G.6, or where the licensee considers that further information or analysis would be relevant as a result of the giving of a Notice under CRC 3G.6, the licensee will provide 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 F: Performance Assessment Submission.

A.7 In accordance with CRC 3G.6(a), LRRCF is defined with reference to efficient costs. In undertaking its assessment of LRRCF, the Authority will take into account, amongst other things, all information submitted by the licensee in its Performance Assessment Submission.

**Step 3: Efficiency Assessment**

A.8 In undertaking its assessment of the licensee's efficient Load Related Expenditure, the Authority will interpret efficiency to mean investment decision-making by a licensee that:

(a) 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,

(b) Resulted in Load Related Expenditure 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 Distribution System.

A.9 Subject to paragraph A.8, the Authority's assessment of efficient Load Related Expenditure will be the same as the licensee's, unless:

(a) The Authority identifies schemes, programmes or items of Load Related Expenditure within the Price Control Period which the Authority does not consider to have been efficient; and

(b) The licensee has not provided a supporting justification of why the schemes, programmes, or items of Load Related Expenditure identified by the Authority under paragraph A.9(a) were efficient, which is adequate in the Authority's reasonable view.

A.10 Subject to A.8, where an efficiency adjustment is made to TLRRCF, the value of that adjustment will be limited to the value of the factors identified under paragraph A.9.

A.11 Subject to paragraph A.8, in assessing "efficiency" the Authority will:

(a) Consider how the licensee conducted and executed the relevant decision-making processes and procedures in practice, including the key drivers of investment decision making; and

(b) Select and review 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 carried out "*net of an* adjustment *for any expenditures avoided, or that may reasonably be expected to be or to have been avoided, as a result of demand-side response or other non-traditional solutions to load related issues*".

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

(a) Cost-benefit or other financial analyses submitted by the licensee that demonstrate the saving that resulted from the solution adopted by the licensee compared to alternative solutions, including conventional solutions, and include information explaining and justifying any assumptions that have been made; and

(b) Evidence provided by the licensee that the solution deployed meets the criteria for Innovative Solutions as defined in the latest version of Annex A of the RIGs.

A.14 Where the Authority's assessment 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:

(a) 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

(b) The costs the licensee incurred 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 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 Steps 3 and 4 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 Base Demand Revenue in the Next 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 licensee to provide the justification in a performance report 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 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 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 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 under CRC 5G.8 when either situation arises.

B.7 CRC 5G.9 specifies the type of information the report required under CRC 5G.8 should contain. In preparing that 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 be supplemented by narrative providing the justification as to why the licensee's Relevant Expenditure has fallen 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, 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 Specific Customer Funded Reinforcement (expressed as a percentage of Gross Load Related Expenditure) 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 Specific Customer Funded Reinforcement expenditure;
- Changes to the Gross Load Related Reinforcement expenditure;
- The factors 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 affect the outcome, there is no simple mechanistic calculation that can be performed. The Authority will, therefore, review the justification provided by the licensee and determine whether or not there is sufficient justification to determine a relevant adjustment.

B.12 Where the Authority concludes that the licensee has provided insufficient justification, 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 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 NASD Closeout Methodology sets out the way in which the Authority will determine for the ED1 Price Control Period:

(a) Whether the licensee has delivered its NASD target;

(b) Whether the licensee has a justified over-delivery of NASD;

(c) Whether the licensee has an unjustified under-delivery of NASD;

(d) The value of the justified over-delivery or unjustified under-delivery of NASD, if any; and

(e) 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 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 electricity distribution, NOMs are referred to as NASD in the Price Control Period.

C.3 As part of its settlement for the ED1 Price Control Period, the licensee committed to delivering a NASD monetised risk target representing the monetised risk change resulting from Asset Replacement, Asset Refurbishment and (if applicable) High Value Projects for asset replacement or refurbishment for a specified subset of asset categories.

C.4 The licensee's NASD targets 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 the ED1 Price Control Period, the licensee had the scope to specify which asset categories would be included within its own targets and consequently there is variation across licensees.

C.5 CRC 5D states that the targets are specified for each licensee in the Network Asset Workbook (NAW). The NAW only specifies asset profiles and is, therefore, supplemented by a Monetised Risk Workbook 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 Price Control Period:

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

C.7 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.8 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,[16] or subsequent revisions to those targets, where the Authority approves such revisions.

C.9 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 licensee with its business plan 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.10 CRC 5D specifies that adjustments will be made to revenues for the Next Price Control Period for justified over-delivery and unjustified under-delivery. Justified over-delivery will also be subject to a 2.5% (after tax) reward, while unjustified under-delivery will be subject to a 2.5% (after tax) penalty, where the percentages are measured relative to the incremental (or avoided) costs associated with the over- or under-delivery.

C.11 CRC 5D also recognises that circumstances can change and that the licensee 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.12 CRC 5D.2 requires the licensee to submit a report by 31 July 2023 setting out the licensee's performance against NASD targets over the ED1 Price Control Period. This

[16] Network Asset Secondary Deliverables rebasing decision

Performance Report will be used alongside the data provided in annual submissions of the RIGs Secondary Deliverables Reporting Pack, associated commentaries and other relevant data sources to carry out quantitative and qualitative assessments of the licensees' performance.

C.13 The process to be followed is based on the framework described in Section 3 of the NOMs Incentive Methodology,[17] as summarised below:

- Stage 1: Licensee submits relevant Non-NASDs risk changes and impact on performance against targets;
- Stage 2: Licensee submits its NASD performance report for the ED1 Price Control Period;
- Stage 3: The Authority assesses the relevant risk changes and the licensee's performance report 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 (or supplements justification provided as part of stage 1 and 2);
- Stage 6: The Authority assesses the justification provided by the licensee; and
- Stage 7: The Authority determines the value of the adjustment(s) required.

C.14 Throughout the process the Authority may ask the licensee for clarification or additional details through supplementary questions. The Authority is considering how an external assessment of asset data quality can feed into the development of RIIO-ED2. Should the Authority have material concerns with the asset data raised during the initial external assessments used in RIIO ED1, the Authority may take this into consideration in reviewing the licensee's NASD performance.

[17] Network Output Measures incentive methodology

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

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

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

C.17 The licensee will provide the information required under paragraph C.16 as part of the performance report required under CRC 5D.2.

C.18 Throughout the Price Control Period, the licensee will submit RIGs Secondary Deliverables Reporting Packs and associated commentaries. These templates contain the net movements across the risk matrices for asset categories associated with Health Index categories included in 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** |
| • Asset replacement<br>• Refurbishment<br>• High Value Projects (with asset replacement/ refurbishment) | • General reinforcement<br>• Faults<br>• High Value Projects (other drivers)<br>• Other investment activities | • Data cleansing<br>• Deterioration<br>• 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 (ie 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 (ie 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 may, therefore, be relevant 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 the delivery of the licensee’s NASD targets.

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

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

(a) The licensee’s performance against its NASD;

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

(c) Any Justified Over-Delivery against its NASD; and

(d) Any Justified Under-Delivery against its NASD.

C.27 As CRC 5D.3 includes a requirement for the licensee to incorporate justification in the performance report, it therefore overlaps with the requirements of stage 5 of the high-level framework in the NOMs Incentive Methodology. The licensee will, therefore, provide some justification as part of the performance report, 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 performance report is covered in Annex F: Performance Assessment Submission.

**Stage 3 – Authority assessment of the relevant risk changes and of the licensee's performance report**

C.29 The Authority will review the details of the relevant risk changes and delivery against the NASD in the licensee's performance report submitted under CRC 5D.2 and, where necessary, the Authority may ask supplementary questions in order to clarify any of the information provided. 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 agrees with the licensee's view of delivery. This may require the Authority to cross-check data against 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 of this stage will be a reference dataset that clearly identifies the impact of relevant risk changes on 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 will be determined when the Authority has gained an understanding of the degree of robustness of the data provided in support of licensee's performance against the licensee's NASD targets, and will be specified in a direction by the Authority.

C.36 If the licensee's performance falls within, or exactly on, the materiality threshold, the Authority will not make a NOMs incentive mechanism revenue adjustment.

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

C.38 The Authority will provide a Notice specifying either the licensee has delivered the NASD targets (ie within the materiality thresholds) or the licensee is required to provide justification for over-delivery or under-delivery. The Authority will issue that Notice by 30 November 2023.

C.39 If the Authority is unable to provide the Notice under paragraph C.38 by 30 November 2023, it will inform the licensee in writing and subsequent deadlines may be revised accordingly.

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

C.40 Where the Authority indicates that 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 report required under stage 2, but the licensee will be given the opportunity to supplement the 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 licensee's performance in the ED1 Price Control Period and the NASD monetised risk target. The licensee may also refer to extensive data that is available from RIGs Annex D Secondary Deliverable data templates and RIGs Annex B Costs and Volumes, submitted by the licensee.

C.43 Part (a) of the definitions of Justified Over-Delivery and Justified Under-Delivery in CRC 5D suggests that the licensee can make those justifications by reference to the total risk position, ie total risk increasing justifies more delivery and total risk decreasing justifies less delivery.

C.44 Part (b) of Justified Over-Delivery and Justified Under-Delivery in CRC 5D allows 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 states the types of information and justification evidence that the licence could provide.

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 such other format, as appropriate.

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

C.48 The licensee must submit any justification that may be required by 31 January 2024, or by such later date as determined 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 submissions;
- RIGs Annex B Cost and Volumes submissions;
- 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 how the Authority will undertake the quantitative assessment.

C.53 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 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 adjustments 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 allowed efficient costs for the ED1 Price Control Period.

C.57 For over-delivery of NASD, the values will be based on the Authority's view of efficient costs. In the Authority's Decision on the Network Output Measures (NOMs) Incentive Methodology dated 6 December 2018, the Authority stated that it would use the lower of the licensee's incurred cost and allowed unit cost. In the event that a unit cost does not exist, the Authority will subject the licensee's incurred costs 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 of over-delivery or under-delivery 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 assessment. It cannot, therefore, constitute an adjustment to allowed expenditure that can be made under CRC 3F.8.

***Derivation of incentive rate for under-delivery***

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

C.62 The NASD Opening Allowances for the Price Control Period were not clearly stated at the Final Determination for the Price Control Period. Consequently those 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 the Final Determination for the ED1 Price Control Period;
- Regional labour scaling factors used in cost benchmarking at the Final Determination for the ED1 Price Control Period;
- Smart grid cost reductions applied at the Final Determination for the ED1 Price Control Period;
- The Authority's view of RPEs at the Final Determination for the ED1 Price Control Period;
- Interpolation used at the Final Determination for the ED1 Price Control Period;
- The appropriate costs to use where the licensee has not carried out like-for-like replacement activity, noting that costs in the licensee's business plan 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 licensee in the licensee's NASD monetised risk targets.

C.63 This results in the following NASD Opening Allowances for the Price Control Period for each licensee:

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

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

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

***Example £ per risk point derivation for under-delivery***

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

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

***Derivation of incentive rate for over-delivery***

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

C.67 The £ per risk point incentive rate for the licensee is derived from the licensee's total incurred costs for NASD-related investment during the ED1 Price Control Period (ie 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 like-for-like replacement activity, 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 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 an assumed 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 (ie 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 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 an assumed 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 resultant, justified risk points of 11,500,000.

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

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

***Valuation of justified over-delivery***

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

***Derivation of Reward/Penalty***

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

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

C.90 As an example the penalty associated with a ED1 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 Costs to determine TUCHVPF.

D.2 The Authority will carry out Steps 1 to 4 to determine TUCHVPF.

**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 TUCHVPov, and its actual or forecast level of High Value Project Costs, in order to determine the requirements for the licensee's Performance Assessment Submission (PAS) to be provided in accordance with Annex F: Performance Assessment Submission.

D.4 The Authority will provide the licensee with guidance on the additional information to be submitted in its PAS.

D.5 If the Authority's high level analysis indicates that the licensee's TUCHVPov is zero and that the licensee has not incurred High Value Project Costs set out in CRC 1B, the licensee will not be required to submit a PAS and there will be no re-opener adjustment for the licensee.

D.6 If the Authority's initial high level analysis indicates that the licensee's TUCHVPov is greater than zero, or the licensee has incurred High Value Project Costs set out in CRC 1B, the Authority will commence a detailed performance assessment as outlined in Steps 2 - 4 below, in order to determine TUCHVPF for the licensee. The Authority will use the value so determined in the calculation of a HVP Re-opener adjustment as specified in paragraph X.23 of Chapter X. The Authority may also request additional information in accordance with Annex F: Performance Assessment Submission.

**Step 2: Efficiency assessment**

D.7 The Authority will carry out an efficiency assessment. In undertaking this assessment, the Authority will interpret efficiency to mean investment decision-making by the licensee that:

- Took into account all relevant information that could reasonably have been expected to be available to the licensee when making the decision; and
- Resulted in expenditure on HVPs during the Price Control 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 Distribution System.

D.8 In deciding whether a proportion of the licensee's expenditure was inefficient, the Authority will take into account:

- The extent to which the justification provided by the licensee for its expenditure is consistent with the approach to the assessment of efficiency as described in paragraph D.7; and
- The quality of supporting evidence provided by the licensee to justify its expenditure, based on the information available to it at the time of the investment decision.

D.9 The Authority will only base its efficiency assessment on information that the licensee had available, or should reasonably have had available, at the time of making its investment decision(s).

D.10 The evidence and analysis that the Authority will take into account in its assessment will include, but not be limited to, the following:

- Evidence that the licensee had appropriate decision making processes and procedures in place and that the licensee applied these processes and procedures when making its investment decision(s);
- Evidence of the technical and (where appropriate) economic need case for the investment and related expenditure, or any relevant obligations (beyond technical or economic) associated with the expenditure;
- Information on the drivers of the High Value Project costs at the time the investment decision was made; and,
- Where appropriate, consideration of alternative options for delivering the outputs/work required.

**Step 3: Avoid double counting of NASD adjustment for HVPs with the primary driver of asset replacement and refurbishment**

D.11 Where, having carried out the assessment under Annex C of the licensee's performance against Network Asset Secondary Deliverables (NASD) targets over the Price Control Period, the Authority identifies a proportion of over-delivery or under-delivery 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 assessment. It cannot, therefore, constitute an adjustment to allowed expenditure that can be made under CRC 3F.8.

**Step 4: Evaluate TUCHVPF**

D.12 Having carried out its efficiency assessment and, if appropriate, valuation of any performance against NASD targets due to High Value Projects, the Authority will then determine the value of TUCHVPF for the licensee.

# 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 CRC 3F, CRC 3G, CRC 5D or CRC 5G that determination will specify the adjustment to the opening RAV balance and Base Demand Revenue[18] in the Next Price Control Period, in accordance with the relevant ED1 licence condition(s). In order to calculate those values, the Authority will undertake the following steps:

(a) Calculate the total value of the adjustment to ED1 Price Control 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;

(b) Restate the value calculated in accordance with paragraph E.1(a) from 2012/13 prices to the price base for the Next Price Control Period, using a calculation that (in the context of the Next Price Control Period financial methodologies) ensures that RPI inflation is recognised up to and including the end of the Price Control Period;

(c) Apportion the value calculated in accordance with paragraph E.1(b) to the relevant regulatory years of the Price Control Period, in accordance with Table E1.

(d) Multiply the values calculated in accordance with paragraph E.1(c) by the licensee's Totex Incentive Strength Rate, as set out in Appendix 1 to CRC 3B.

(e) Calculate the total value of the financial adjustment, as at the first year of the Next Price Control Period, by:

i. Applying the relevant Time Value of Money Adjustment to each of the values calculated in accordance with paragraph E.1(d) to reflect deferral to the 2023/24 regulatory year; and

ii. Taking the sum of the resulting values.

[18] Adjustments are made to the licensee's RAV and Base Demand Revenue to ensure licensees (and their customers) are in the same position (or as close to that as possible) as they would have been if the licensee's allowances had been set at the final level.

(f) Calculate the part of the financial adjustment calculated in accordance with paragraph E.1(e) 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 Next Price Control Period should be set at the level that would have occurred had the licensee's ED1 allowances been subject to the adjustments calculated in accordance with paragraph E.1(c) within the Price Control Period. This principle will have been met for the purpose of these financial methodologies if the calculation:

i. Multiplies the annual values calculated in accordance with paragraph E.1(d) by the licensee's Capitalisation Rate, as set out for the licensee in Appendix 1 to CRC 3B; and

ii. Subtracts from the values calculated in accordance with paragraph E.1(f)(i) the amount of depreciation that would have occurred in the Price Control Period and reflecting the asset life applied for each regulatory year; and

iii. Takes the sum of the resulting values.

(g) Subtract the value calculated in accordance with paragraph E.1(f), with any necessary Time Value of Money Adjustment to place that value on a consistent basis for the 2023/24 regulatory year, from the total value of the financial adjustment calculated in accordance with paragraph E.1(e) in order to calculate the adjustment that is to be made directly to the licensee's Next Price Control Period Base Demand Revenue, and spread that value evenly across the regulatory years that constitute the Next Price Control Period.

(h) Subtract from the values calculated in accordance with paragraphs E.1(f) and E.1(g) any provisional amounts for those values included in the calculation of Opening Base Revenue Allowances and opening RAV balance for the Next Price Control Period.

(i) Use the values calculated in accordance with paragraph E.1(h) as revisions to the opening RAV balance and Base Demand Revenue for each regulatory year in the Next Price Control Period in any determination under the relevant ED1 licence reference from Table E1 below and recognising in that determination that:

i. 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

ii. A Time Value of Money Adjustment will be applied within the 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: Relevant values, licence conditions, and adjustment profiles**

| **Closeout methodology** | **Relevant values** | **Relevant ED1 licence reference** | **Basis for profiling adjustments** |
|---|---|---|---|
| Load related expenditure | The LRRCF values set out in appendix 1 to CRC 3G | CRC 3G.20 | Timing profile of LRRC values |
| Net to gross adjustment | The LRRCF values set out in appendix 1 to CRC 3G | CRC 5G.14 | Timing profile of LRRC values |
| Network asset secondary deliverables | The Licensee's total annual NASD-related expenditure in the ED1 Price Control Period | CRC 5D.9 or CRC 5D.11 | Timing profile of incurred expenditure[19] |
| High value projects | Expenditure allowances for High Value Project Costs set out in appendix 1 to CRC 3F | [licence condition still to be written and consulted upon][20] | Timing profile of Aggregate Baseline Expenditure Allowances |
| Shetland | UCSEFEC, UCSEBC and UCSESPC values, as appropriate, including the timing profile of adjustments set out in the Authority's determination under CRC 3F.26 | [licence condition still to be written and consulted upon] | Timing profile of adjustments set out in the determination |
| Link Boxes | UCLB values | [licence condition still to be written and consulted upon] | Timing profile of allowances |

[19] This decision to profile NASD adjustments in line with the associated allowances may not be

# 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. The submission dates for each cost area are provided in Table F1.

F.3 The Authority will only request that the licensee includes information in the PAS if the Authority identifies gaps in its existing information, or where specific questions have arisen as a result of the Authority's initial high level analysis. The Authority will only request information from the licensee that is proportionate to the results of the Authority's initial high level analysis and will include any information the Authority may reasonably require in order to address the issues identified by the Authority. The information that should be included in the PAS is set out in this Annex; this list is not exhaustive, and the Authority may request further information as required.

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/or Link Boxes the licensee is required to submit in its PAS. The Authority will request that information 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 that information.

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appropriate for the Transmission or Gas Distribution price controls, and a decision on the profile of adjustments in those sectors will be made based on the evidence available at the time.

[20] We note that developing a methodology in advance of the licence condition being written and put in place is not the traditional approach. However, we have used a principles-based approach to developing the methodology for each element of closeout, and the licence condition that will follow is to enable this. All elements that are subject to closeout have been signalled in RIIO-ED1 documents (Strategy Decision, Final Determinations, or reopener decisions).

**Table F1: PAS submission deadlines**

| Licence condition | Submission deadline |
|---|---|
| CRC 3F (High Value Projects Costs, Link Box Costs) | 31 July 2023 |
| CRC 3G (Load Related Expenditure) | 31 December 2023 |
| CRC 5D (Network Asset Secondary Deliverables) | 31 July 2023 (Performance Report deadline) |
| CRC 5G (Net to Gross) | 31 July 2023 (Performance Report deadline) |

## 1 Load Related Expenditure

F.6 The extent of the 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 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:

(a) The original technical solution;

(b) Any changes to that technical solution along with an explanation of the reason for changing the solution;

(c) Where relevant, information on Load Indices or utilisation relevant to the scheme; and

(d) Any relevant financial or cost benefit analysis, or analysis of options the licensee undertook at the time the licensee made decisions on expenditure.

*Connections within the price control*

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

(a) An explanation of changes in the volume and mix of connection schemes;

(b) Information on any trade-off / or relationship with General Reinforcement; and

(c) Information on changes to the number of connections carried out by independent connection providers, compared to those anticipated in the licensee's 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 PAS:

(a) An overview of Primary General Reinforcement expenditure carried out during the Price Control Period;

(b) Information on load indices and utilisation;

(c) For schemes that were delayed, deferred or where a new requirement arose, an explanation of why these changes occurred, including where Primary General Reinforcement was impacted by changes to connections activity; and

(d) 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 secondary General reinforcement, the Authority may require the licensee to provide in its PAS:

(a) A narrative of its secondary reinforcement expenditure in the Price Control Period, with reference to its allowed expenditure for secondary reinforcement in the Price Control Period. This narrative 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 included in the licensee's Price Control Period business plan); and

(b) 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 PAS a narrative regarding its Fault Level reinforcement expenditure for the Price Control Period that:

(a) Was made with reference to allowed expenditure for Fault Level reinforcement in the Price Control Period; and

(b) Includes 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 PAS a narrative regarding expenditure during the Price Control Period, which should:

(a) Be made with reference to the allowed expenditure for NTCC in the Price Control Period; and

(b) Include reference to the drivers that led to the need for the expenditure on NTCC schemes or changes in expenditure compared to the Price Control Period baselines.

*Avoided Reinforcement Expenditure*

F.15 For Avoided Reinforcement Expenditure to qualify under Step 4 of the procedure set out above at Annex A: 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 PAS:

(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;

(b) A justification of the need for the reinforcement, which the Innovative Solutions addressed, avoided or deferred, and the licensee's best estimate of the cost of a conventional reinforcement solution;

(c) A demonstration that the Innovative Solutions were in the interests of Customers along with details of alternative solutions considered by the licensee;

(d) A demonstration that the Innovative Solutions avoided costs and meet the criteria set out in the relevant version of Annex A of the ED1 RIGs (or, to the extent the costs did not, any evidence the licensee can provide on why the Innovative Solutions should be recognised);

(e) Financial or cost benefit analyses to demonstrate that the Innovative Solutions delivered (or are continuing to deliver) benefits for Customers; and

(f) 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 and the justification reports required by stage 5 of Annex C: ED1 Network Asset Secondary Deliverables Closeout methodology.

F.18 This guidance should be used alongside the guidance provided in Appendix 1 of the NOMs Incentive Methodology, which specifies the types of information required for the performance report. For the avoidance of doubt, this Annex takes precedent if there is a conflict with the guidance provided in Appendix 1 of the NOMs Incentive Methodology.

*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 Workbook.

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 when compared to 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 (eg 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 trade risk 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 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 performance report.[21]

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.

[21] For the avoidance of doubt, this performance report will be considered the PAS for NASD.

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

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

*Provision of initial justification in the Performance Report*

F.27 CRC 5D requires that justification of performance is provided as part of the performance report the licensee must submit by 31 July 2023. The NOMs Incentive Methodology recognises that justification can be provided as part of the performance report and 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:

(a) An explanation of the drivers of the licensee's NASD Interventions and the supporting rationale for those Interventions undertaken in the Price Control Period;

(b) An explanation of trade-offs between HI Asset Category Interventions, ie how the licensee has reprioritised work across HI Asset Categories and a justification as to why the reprioritisation was appropriate; and

(c) An explanation of trade-offs between asset replacement and refurbishment work and why, in the licensee's view, the particular trade-off was appropriate.

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

*Provision of additional Justification Report*

F.30 If the Authority determines that a licensee has delivered monetised risk outside the materiality threshold (deadband) around the NASD monetised risk target, the licensee will be required to submit a justification report in accordance with Stage 5 of the NOMs Incentive Methodology.

F.31 CRC 5D requires that initial justification of performance is provided as part of the performance report to be submitted by 31 July 2023.

F.32 The justification 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 justification report.

### 3 High Value Projects

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

F.35 The Authority may require that the licensee's PAS includes summary information on:

(a) The HVPs that the licensee has completed during the Price Control Period;

(b) the HVPs that the licensee deferred or delayed into later price controls or cancelled during the RIIO-ED1 period;

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

(d) the licensee's investment decision-making processes relating to RIIO-ED1 HVPs.

*HVP Actual Incurred expenditure*

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

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

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

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

(d) analysis of options and alternative investment solutions considered; and,

(e) arrangements for management and delivery of RIIO-ED1 HVPs.

*Avoided HVP Expenditure*

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

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

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

(b) justification of the need for the investment which the Innovative Solutions are meeting; and,

(c) demonstration that the Innovative Solutions are in the interests of consumers and details of alternative solutions.

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

## 4 Link Box Costs

F.40 The extent of narrative and supporting evidence provided to the Authority should be proportionate to the degree that the licensee’s Actual RIIO-ED1 Link Box Replacement Volumes are higher or lower than the Allowed RIIO-ED1 Link Box Replacement Volumes. This applies to SPN and SPMW only.

F.41 The PAS should explain any data quality issues over the Price Control Period that have impacted the costs associated with the Actual RIIO-ED1 Link Box Replacement Volumes.

F.42 Any explanation of changes to activities should be given relative to the activities that could reasonably assumed to have been catered for in the Allowed RIIO-ED1 Link Box Replacement Volumes.