

Supplementary Annex 1

Informal consultation on changes
to Scottish Hydro Electric Power
Distribution Plc's Electricity
Distribution licence Special
Conditions for the Shetland
Extended Interim Energy Solution

1. Background and purpose

Chapter Summary

Explains the purpose of this document and sets out the details for responding to this consultation.

Purpose of this document

1.1. SSEN operates the electricity distribution in the North of Scotland under licence as Scottish Hydro Electric Power Distribution (SHEPD)¹. In order to incorporate the extended interim energy solution, there will need to be modifications to SHEPD's electricity distribution special licence conditions. This document sets out these proposed modifications.

1.2. The modifications will only affect certain conditions in SHEPD's licence. Table 1.1 overleaf lists the conditions that are likely to be affected. Section 2 explains the reasons for the modifications, and Appendix 1 highlights in yellow (and green where numbers will be finalised following this consultation) proposed changes to relevant sections of the licence.

1.3. We will publish a statutory consultation on the proposed modifications to SHEPD's licence in due course.

1.4. In addition, in order to allow SHEPD to recover a number of the uncertain costs items we will need to make changes to Chapter 7 of the RIIO-ED1 Financial Handbook. We intend to take this forward as part of developing the methodologies for the RIIO-ED1 Close-out process.

Responding to this consultation

1.5. We welcome comments on this document by 8 June 2018 to RIIO.ED1@ofgem.gov.uk or in writing to:

Grant McEachran
RIIO - Electricity Distribution
Ofgem
Commonwealth House
32 Albion Street
Glasgow
G1 1LH

1.6. Unless clearly marked confidential, all responses will be published on our website.

¹ As Scottish Hydro Electric Power Distribution (SHEPD) is the licence holder, we use SHEPD in this document.

Table 1.1 – Special Conditions covered by this consultation

Chapters		Proposed change for the Extended Interim Energy Solution
CHAPTER 1: INTERPRETATION OF PART 4		
No changes proposed to Chapter 1		
CHAPTER 2: ELECTRICITY DISTRIBUTION REVENUE RESTRICTION		
CRC 2A.	Restriction of Allowed Distribution Network Revenue	Amendments
CRC 2B.	Calculation of Allowed Pass-Through Items	Amendments
CRC 2C.	Broad Measure of Customer Service Adjustment	No change
CRC 2D.	Adjustment of licensee’s revenues to reflect interruptions-related quality of service performance	No change
CRC 2E.	Incentive on Connections Engagement	No change
CRC 2F.	Time to Connect Incentive	No change
CRC 2G.	The Losses Discretionary Reward	No change
CRC 2H.	The Network Innovation Allowance	No change
CRC 2I.	Not Used	No change
CRC 2J.	Low Carbon Networks Fund	No change
CRC 2K.	Margins on licensee’s Connection Activities	No change
CRC 2L.	Revenue adjustments in respect of performance failures	No change
CRC 2M.	Adjustment of licensee’s revenues for the residual distribution losses incentive	No change
CRC 2N.	Assistance for high-cost distribution areas for SSEH	No change
CRC 2O.	Not used	No change
CRC 2P.	Shetland Variable Energy Costs Pass-Through Items	No change
CRC 2Q.	Arrangements for the recovery of costs for an integrated plan to manage supply and demand on Shetland	No change
CRC 2R.	Shetland Extension Variable Energy Cost Pass-Through Items	New Condition
CHAPTER 3: ANNUAL ITERATION PROCESS – ADJUSTMENTS TO THE REVENUE RESTRICTION		
CRC 3A.	Legacy price control adjustments	No change
CRC 3B.	Determination of PCFM Variable Values relating to actual Totex expenditure for Totex Incentive Mechanism Adjustments	No change
CRC 3C.	Specified financial adjustments	No change
CRC 3D.	The Innovation Roll-out mechanism	No change
CRC 3E.	Smart Meter Roll-out Costs	No change
CRC 3F.	Arrangements for the recovery of uncertain costs	Amendments
CRC 3G.	Revising the allowed level of Load Related Expenditure	No change
CRC 3H.	Allowed expenditure on improving services to Worst Served Customers	No change
CRC 3I.	Not used	No change
CRC 3J.	Allowed expenditure on Visual Amenity Projects	No change
CRC 3K.	Not used	No change
CHAPTER 4: PRICE CONTROL FINANCIAL INSTRUMENTS		
No changes proposed to Chapter 4		
CHAPTER 5: OTHER REVENUE RESTRICTION RELATED CONDITIONS		
No changes proposed to Chapter 5		

2. Explanation of the reasons for the proposed licence changes

Chapter Summary

Explains the reasons for the proposed changes to SHEPD's licence in respect of the Shetland extended interim energy solution.

2.1 There will be a number of costs associated with the Shetland extended interim energy solution. The costs will broadly fall under two categories: pass-through and uncertain costs. Pass-through costs are those outside of SHEPD's control, whereas uncertain costs are subject to reopeners, in this case as part of the RIIO-ED close out process.

2.2 In order to allow these costs to be recovered, there will need to be modifications to SHEPD's electricity distribution special licence conditions. These modifications are summarised below.

Pass-through costs – modifications to CRC 2B and introduction of CRC 3R

2.3 We propose two main modifications to CRC 2B:

- (1) Introduction of a new term: Shetland Extension Variable Energy Costs (SEVEC) – to allow SHEPD to reclaim the necessary variable costs for ongoing operation of LPS until an enduring solution is introduced.
- (2) Introduction of a new term: Shetland New Energy Solution Residual Costs (SNESRC) – to allow NGSL to recover certain efficiently incurred costs.

2.4 In addition, we proposed the introduction of a new licence condition, CRC 2R, to outline the calculation of SEVECA (the Shetland Extension Variable Energy Costs term) which then applies in CRC 2B.

2.5 These are discussed in further detail below

Shetland Extension Variable Energy Costs

2.6 At present, the Shetland Variable Energy Costs (SEC) term allows SHEPD to reclaim LPS fuel purchases, including contingency fuel, and the necessary EU Emissions Trading System environmental permits. From this cost is subtracted the wholesale electricity price that energy suppliers pay SSE Generation. CRC 2P sets out the calculation of the SEC term that applies in CRC 2B.

2.7 The cost allowances are shown in Table 2.1. Like the other cost allowances, currently this net cost is one of the costs reclaimed from all the electricity consumers in SHEPD's North of Scotland area.

Table 2.1 - SHEPD existing cost allowances for Shetland Variable Energy Costs (£m, 2012/13 prices)

2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
4.63	4.66	6.05	6.43	0.00	0.00	0.00	0.00

2.8 We intend to continue to allow SHEPD to reclaim the necessary costs for ongoing operation of LPS until an enduring solution is introduced which is currently anticipated by 1 April 2025. Therefore, we propose to include a new term Shetland Extension Variable Energy Costs (SEVEC) to CRC 2B, which would extend the existing recovery arrangements for SHEPD. The associated allowances, which are subject to consultation, are shown in Table 2.2.

Table 2.2: SHEPD cost allowances for Shetland Extension Variable Energy Costs (£m, 2012/13 prices)

2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
0.00	0.00	0.00	0.00	8.6	8.2	8.0	8.0

Shetland New Energy Solution Residual Costs

2.9 NGSLL incurred costs in the period between their announcement as preferred bidder and our decision to reject the proposed costs of their solution. We consider it appropriate that NGSLL is able to recover certain efficiently incurred costs. As the parties are not distribution licence holders, this must be provided through SHEPD's licence, who will in turn pass those costs to NGSLL.

2.10 SHEPD, in consultation with an Independent Auditor, has undertaken a detailed review of NGSLL's costs and submitted to Ofgem a proposal to recover £5.3m. As these costs were not controlled or incurred by SHEPD, it is proposed they are treated as pass-through. A new pass-through term, Shetland New Energy Solution Residual Costs (SNESRC) would be added to CRC 2B to provide for a one-off pass-through of these costs in 2017/18.

Introduction of CRC 2R

2.11 We have introduced a new condition, CRC 2R. This condition sets out the calculation of SEVECA term that applies in CRC 2B for the purposes of pass-through costs. It does not provide for the recovery of the costs that are provided in base revenue.

2.12 This is similar to the existing CRC 2P that applies to SEC.

Uncertain costs – changes to CRC 3F

2.13 We propose two main modifications to CRC 3F:

- (1) Introduction of a new term Shetland Extension Fixed Energy Costs (UCSFE) – to allow SHEPD to reclaim necessary fixed costs for the ongoing operation of LPS.

- (2) Introduction of a new term Shetland Enduring Solution Process Costs (UCSESPC) – to allow SHEPPD to be proactive in securing an enduring solution for Shetland.

2.14 These cost categories are discussed in further detail below. We note that changes the methodology for the uncertainty mechanisms for SEFEC and SESPC will be drafted as part of the close-out methodology, and reflected in the PCFH / PCFM at the relevant time

Shetland Extension Fixed Energy Costs

2.15 At present, the Shetland Uncertain Energy Costs (UCSFE) term covers SHEPD purchases electricity from Sullom Voe Terminal, operational running costs of LPS and any necessary LPS replacement investment up to 2018/2019. The associated allowances are shown in Table 2.3.

Table 2.3: SHEPD cost allowances for Shetland Uncertain Energy Costs (£m, 2012/13 prices)

2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
20.80	21.09	21.27	21.96	0.00	0.00	0.00	0.00

2.16 To maintain security of supply, we intend to continue to allow SHEPD to reclaim necessary costs for the ongoing operation of LPS, including in relation to purchases from Sullom Voe Terminal. Thus, a new term Shetland Extension Fixed Energy Costs (UCSEFEC) to be added to CRC 3F would extend these Shetland Uncertain Energy Costs recovery arrangements or SHEPD for LPS operation and payments for third party Power Purchase Agreements. The associated allowances, subject to consultation, are shown in Table 2.4.

Table 2.4: SHEPD cost allowances for Shetland Extension Fixed Energy Costs (£m, 2012/13 prices)

2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
0.00	0.00	0.00	0.00	27.8	17.7	15.9	15.4

Shetland Enduring Solution Process Costs

2.17 SHEPD considers it imperative that it has a proactive role as DSO in securing an enduring solution for Shetland. This will involve carrying out feasibility and stakeholder engagement activities over 2017/18 and 2018/19 to assess the viability of a link-based solution. It will also require detailed scenario planning.

2.18 We recognise that SHEPD may incur costs in preparing for an enduring energy solution and that doing so will be in the interests of securing supply for Shetland. A new term, Shetland Enduring Solution Process Costs (UCSESPC), is proposed to be included in CRC 3F to provide for these costs. The associated allowances, subject to consultation, are shown in Table 2.5.

Table 2.5: SHEPD cost allowances for Shetland Enduring Solution Process Costs (£m, 2012/13 prices)

2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
0.00	0.00	0.00	0.00	1.3	0.8	0.6	0.3

Proposed modifications to CRC 2A

2.19 We have proposed two additional modifications to CRC 2A:

- (1) Introduction of a new term: Present Value Adjustment (PVF) - On reviewing SHEPD's special conditions it was noticed that the definition for the PVF term, was missing. A proposed modification to CRC 2A.10 rectifies this.
- (2) Introduction of a new term: Shetland Extension Variable Energy Costs (SEVEC_t) – this adds the term SEVEC which relates to the ongoing variable costs of running Lerwick Power Station to formula which calculates the combined value of all revenue adjustments for the licensee.

Other small modifications

2.20 We noticed that the sub-paragraph numbering was incorrect for 2B.15 and 2B.29. This has also been corrected.

Appendix 1: Proposed licence changes

CRC 2A. Restriction of Allowed Distribution Network Revenue

Introduction

2A.1 This condition:

- (a) establishes the charging restrictions that determine the level of Allowed Distribution Network Revenue that may be recovered by the licensee from Use of System Charges; and
- (b) sets out the obligation of the licensee in respect of those restrictions.

Part A: Licensee's obligation

2A.2 The licensee, in setting Use of System Charges, must use its reasonable endeavours to ensure that, in Regulatory Year t , Regulated Distribution Network Revenue does not exceed its Allowed Distribution Network Revenue.

Part B: Calculation of Allowed Distribution Network Revenue (AR_t)

2A.3 Allowed Distribution Network Revenue, in Regulatory Year t , is derived in accordance with the following formula (in this condition, the Principal Formula):

$$AR_t = BR_t + IP_t + PT_t + NIA_t + LCN_t - AUM_t + CGSRA_t + PPL_t - K_t$$

2A.4 In the Principal Formula:

- AR_t means the amount of Allowed Distribution Network Revenue in Regulatory Year t .
- BR_t means the amount of Base Demand Revenue in Regulatory Year t , as derived in accordance with the formula set out in Part C of this condition.
- IP_t means the incentive revenue adjustment made in Regulatory Year t , as derived in accordance with the formula set out in Part D of this condition.
- PT_t means the Allowed Pass-Through Items revenue adjustment made in Regulatory Year t , as derived in accordance with CRC 2B (Calculation of Allowed Pass-Through Items).
- NIA_t means the Network Innovation Allowance revenue adjustment made in Regulatory Year t , as derived in accordance with CRC 2H (The Network Innovation Allowance).
- LCN_t means the low carbon networks fund revenue adjustment made in Regulatory Year t , as derived in accordance with CRC 2J (Low Carbon Networks Fund).
- AUM_t means the total amount of any sums remaining unpaid pursuant to the requirements of a Clawback Direction given in accordance with the

provisions of Part B of CRC 2K (Margins on licensee's Connection Activities) one year after the licensee has received that direction.

$CGSRA_t$ means the adjustment for payments made by the licensee in respect of its failure to achieve connections performance standards, as derived in accordance with CRC 2L (Revenue adjustments in respect of performance failures).

PPL_t means the DPCR4 residual distribution losses incentive value revenue adjustment made in Regulatory Year t , as derived in accordance with CRC 2M (Adjustment of licensee's revenues for the residual distribution losses incentive).

K_t means the correction factor revenue adjustment made in Regulatory Year t , as derived in accordance with the formula set out in Part E of this condition.

Part C: Calculation of Base Demand Revenue (BR_t)

2A.5 For the purposes of the Principal Formula, the amount of BR_t is derived in accordance with the following formula:

$$BR_t = (PU_t + MOD_t + TRU_t) \times RPIF_t$$

2A.6 In the formula for the BR_t term above:

PU_t means the amount set against the licensee's name in Appendix 1 of this condition and represents the Opening Base Revenue Allowance for Regulatory Year t , as determined by the Authority in relation to the distribution of electricity to and from premises.

MOD_t is zero in Regulatory Year 2015/16 and in each subsequent Regulatory Year is the value of the incremental change for Regulatory Year t to the licensee's Opening Base Revenue Allowance, as derived in accordance with the Annual Iteration Process set out in Parts A and B of CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

TRU_t is zero in Regulatory Years 2015/16 and 2016/17 and in each subsequent Regulatory Year is the revenue adjustment made in Regulatory Year t in respect of the actual value of the Retail Prices Index in Regulatory Year $t-2$ minus the assumed value of the Retail Prices Index in Regulatory Year $t-2$, as derived in accordance with paragraph 2A.9.

$RPIF_t$ means the price index adjustment factor in Regulatory Year t , as derived in accordance with paragraph 2A.7.

2A.7 For the purposes of paragraph 2A.6, $RPIF_t$ is derived in accordance with the following formula:

$$RPIF_t = RPIA_{t-2} \times (1 + GRPIF_{t-1}) \times (1 + GRPIF_t)$$

2A.8 In the above formula for $RPIF_t$:

$RPIA_t$ means the arithmetic average of the Retail Prices Index published or determined with respect to each of the twelve months in Regulatory Year t divided by the arithmetic average of the Retail Prices Index published or determined with respect to each of the twelve months 1 April 2012 to 31 March 2013 as derived in accordance with the following formula:

$$RPIA_t = \frac{RPI_t}{RPI_{2012/13}}$$

where:

RPI_t means the arithmetic average of the Retail Prices Index published or determined with respect to each of the twelve months from 1 April to 31 March in Regulatory Year t .

$RPI_{2012/13}$ means the arithmetic average of the Retail Prices Index published or determined with respect to each of the twelve months from 1 April 2012 to 31 March 2013.

and:

$$GRPIF_t = (0.75 \times GRPIF_c) + (0.25 \times GRPIF_{c+1})$$

$$GRPIF_{t-1} = (0.75 \times GRPIF_{c-1}) + (0.25 \times GRPIF_c)$$

where:

$GRPIF_c$ means the Retail Prices Index Forecast Growth Rate for calendar year c , where c denotes the calendar year in which Regulatory Year t begins and the expressions $c-1$ and $c+1$ are interpreted accordingly; and in each such case the Retail Prices Index Forecast Growth Rates for calendar years $c-1$, c and $c+1$ are taken from the November edition of the HM Treasury publication “Forecasts for the UK Economy”, in Regulatory Year $t-1$.

2A.9 For the purposes of paragraph 2A.6, TRU_t is derived in accordance with the following formula:

$$TRU_t = \left(\frac{RPIA_{t-2} - RPIF_{t-2}}{RPIA_{t-2}} \right) \times REV_{t-2} \times PVF_{t-2} \times PVF_{t-1}$$

2A.10 In the above formula for TRU_t :

PVF_t means the present value adjustment term for Regulatory Year t and is calculated as one plus the Vanilla Weighted Average Cost of Capital for the licensee as derived by the Authority in accordance with the Annual Iteration Process, and the expressions PVF_{t-1} and PVF_{t-2} are to be interpreted accordingly.

REV_{t-2} means the amount (in 2012/13 prices) in Regulatory Year $t-2$ of the combined value of all revenue adjustments for the licensee provided for in the provisions referred to in relevant Charge Restriction Conditions indexed

by the Retail Prices Index as derived in accordance with the formula in paragraph 2A.11.

2A.11 For the purposes of paragraph 2A.10, REV_{t-2} is derived in accordance with the following formula:

$$REV_{t-2} = \frac{BR_{t-2} + LF_{t-2} + RB_{t-2} + TB_{t-2} + SMC_{t-2} + SMIT_{t-2} + RF_{t-2} + SEC_{t-2} + IQ_{t-2} + LDR_{t-2} + SEVECT}{RPIF_{t-2}}$$

2A.12 In the above formula for REV_{t-2} :

BR_{t-2} means the amount of Base Demand Revenue in Regulatory Year t-2, as derived in accordance with the formula set out in paragraph 2A.5.

LF_{t-2} means the amount of the licence fee adjustment in Regulatory Year t-2 as derived in accordance with Part B of CRC 2B.

RB_{t-2} means the amount of the Business Rates adjustment in Regulatory Year t-2 as derived in accordance with Part C of CRC 2B.

TB_{t-2} means the amount of the Transmission Connection Point Charges adjustment in Regulatory Year t-2 as derived in accordance with Part D of CRC 2B.

SMC_{t-2} means the amount of the Smart Meter Communication Licensee Costs adjustment in Regulatory Year t-2 as derived in accordance with Part E of CRC 2B.

$SMIT_{t-2}$ means the amount of the Smart Meter Information Technology Costs adjustment in Regulatory Year t-2 as derived in accordance with Part F of CRC 2B.

RF_{t-2} means the amount of the Ring Fence Costs adjustment in Regulatory Year t-2 as derived in accordance with Part G of CRC 2B.

SEC_{t-2} means the Shetland Variable Energy Costs, in Regulatory Year t-2, as derived in accordance with Part H of CRC 2B.

IQ_{t-2} means the interruptions-related quality of service incentive revenue adjustment made in Regulatory Year t-2, as derived in accordance with CRC 2D (Adjustment of licensee's revenues to reflect interruptions related quality of service performance), except in Regulatory Years t-2 beginning on 1 April 2015 and 1 April 2016 when IQ_{t-2} will be zero for the purposes of this calculation.

LDR_{t-2} means the amount of the Losses Discretionary Reward scheme revenue adjustment made in Regulatory Year t-2, as derived in accordance with CRC 2G (The Losses Discretionary Reward).

SEVEC_t means the Shetland Extension Variable Energy Costs in Regulatory Year t-2, as derived in accordance with Part I of CRC 2B.

Part D: Calculation of the incentive revenue adjustment (IP_t)

2A.13 For the purposes of the Principal Formula, the amount of IP_t is derived in accordance with the following formula:

$$IP_t = BM_t + IQ_t + ICE_t + TTC_t + LDR_t$$

2A.14 In the above formula for IP_t:

BM_t means the broad measure of customer service revenue adjustment made in Regulatory Year t, as derived in accordance with CRC 2C (Broad Measure of Customer Service Adjustment).

IQ_t means the interruptions-related quality of service incentive revenue adjustment made in Regulatory Year t, as derived in accordance with CRC 2D.

ICE_t means the incentive on connections engagement revenue adjustment made in Regulatory Year t, as derived in accordance with CRC 2E (Incentive on Connections Engagement).

TTC_t means the Time to Connect Incentive revenue adjustment made in Regulatory Year t, as derived in accordance with CRC 2F (Time to Connect Incentive).

LDR_t means the Losses Discretionary Reward scheme revenue adjustment made in Regulatory Year t, as derived in accordance with CRC 2G.

Part E: Calculation of the correction factor (K_t)

2A.15 For the purposes of the Principal Formula for the licensee, subject to paragraph 2A.17, K_t is derived in accordance with the following formula:

$$K_t = (RD_{t-2} - AR_{t-2}) \times \left(1 + \left(\frac{I_{t-2} + PR_{t-2}}{100}\right)\right) \times \left(1 + \left(\frac{I_{t-1} + 1.5}{100}\right)\right)$$

2A.16 In the above formula for K_t:

RD_{t-2} means the Regulated Distribution Network Revenue in Regulatory Year t-2, except in the Regulatory Year beginning 1 April 2016 where RD_{t-2} is the Regulated Combined Distribution Network Revenue, as defined in CRC 2 (Definitions for the Charge Restriction Conditions) of this licence in the form in which it was in force at 31 March 2015.

AR_{t-2} means the amount of the Allowed Distribution Network Revenue in Regulatory Year t-2, except in the Regulatory Year beginning 1 April 2016 where AR_{t-2} is the Combined Allowed Distribution Network Revenue, as derived in accordance with Part B of CRC 3 (Restriction of Distribution Charges: Use of System Charges) of this licence in the form in which it was in force at 31 March 2015.

I_t means the Average Specified Rate in Regulatory Year t.

PR_{t-2} means the interest rate adjustment as derived in accordance with Part F of this condition.

2A.17 In Regulatory Year 2015/16, K_t will have the value of zero.

Part F: Interest adjustment for over-recoveries and under-recoveries of revenue

2A.18 For the purposes of Part E of this condition, the value of the interest rate adjustment PR_{t-2} is derived as follows:

- (a) if, in respect of Regulatory Year $t-2$, RD_{t-2} exceeds 106 per cent of AR_{t-2} , PR_{t-2} will have the value of 3;
- (b) if, in respect of Regulatory Year $t-2$, RD_{t-2} is less than 94 per cent of AR_{t-2} , PR_{t-2} will have the value of zero; and
- (c) in all other cases PR_{t-2} will have the value of 1.5.

2A.19 This paragraph applies where the Authority, having due regard to the purpose of this condition and after consulting with the licensee, is satisfied that RD_{t-2} in respect of Regulatory Year $t-2$ has, for reasons outside the reasonable control of the licensee, either:

- (a) exceeded 106 per cent of AR_{t-2} ; or
- (b) been less than 94 per cent of AR_{t-2} .

2A.20 Where paragraph 2A.19 applies, the Authority may direct the licensee to change the value of PR_{t-2} to a value which is not less than zero and not more than 3.

Part G: Treatment of charges in the event of over-recovery

2A.21 Paragraph 2A.22 applies from 1 April 2018.

2A.22 If, in respect of two successive Regulatory Years $t-2$ and $t-3$, the licensee's Regulated Distribution Network Revenue in each of those Regulatory Years exceeds 110 per cent of Allowed Distribution Network Revenue for those Regulatory Years, the licensee:

- (a) must provide an explanation for that event in writing to the Authority by 31 July in the associated Regulatory Year $t-1$; and
- (b) must not increase its Use of System Charges for the Regulatory Year t except and to the extent that the Authority has consented to such an increase.

Part H: Treatment of charges in the event of under-recovery

2A.23 Paragraph 2A.24 applies from 1 April 2018.

2A.24 If, in respect of two successive Regulatory Years $t-2$ and $t-3$, the licensee's Regulated Distribution Network Revenue in each of those Regulatory Years is less than 90 per cent of the Allowed Distribution Network Revenue for those Regulatory Years, the licensee:

- (a) must provide an explanation for that event in writing to the Authority by 31 July in the associated Regulatory Year $t-1$; and

- (b) must use its reasonable endeavours in setting Use of System Charges to recover the Allowed Distribution Network Revenue in Regulatory Year t.

Part I: Interpretation

2A.25 For the purposes of this condition:

Regulated Distribution Network Revenue means the revenue derived by the licensee from Use of System Charges made for the provision of Distribution Services to Customers in respect of a Regulatory Year.

Retail Prices Index means:

- (a) the general index of retail prices published by the Office for National Statistics each month in respect of all items; or
- (b) if that index in respect of any month relevant for the purposes of the Charge Restriction Conditions has not been published, such price index as the Authority may, after consultation with the licensee, determine to be appropriate in the circumstances; or
- (c) if there is a material change in the basis of that index, such other index as the Authority may, after consultation with the licensee, determine to be appropriate in the circumstances (provided that any index so determined may not have a retroactive effect on any formula or other provision of the Charge Restriction Conditions).

Retail Prices Index Forecast Growth Rate means:

- (a) the growth rate (which is presented as a percentage) as defined as the “New forecasts (marked *)” in the HM Treasury document, “Forecasts for the UK Economy”, published in November each year; or
- (b) if that growth rate in respect of any year has not been published, such growth rate as the Authority may, after consultation with the licensee, determine to be appropriate in the circumstances; or
- (c) if there is a material change in the basis of that growth rate, such other growth rate as the Authority may, after consultation with the licensee, determine to be appropriate in the circumstances (provided that any index so determined may not have a retroactive effect on any formula or other provision of the Charge Restriction Conditions).

**Vanilla Weighted
Average Cost of
Capital**

has the meaning given to that term in the glossary of the
ED1 Price Control Financial Handbook.

CRC 2B. Calculation of Allowed Pass-Through Items

Introduction

- 2B.1 This condition sets out the calculation of the amount of the term PT (the allowed pass-through term) that applies in CRC 2A (Restriction of Allowed Distribution Network Revenue).
- 2B.2 The allowed pass-through term in CRC 2A amends the licensee's Allowed Distribution Network Revenue so as to allow certain costs as specified below to be passed through to users of the licensee's Distribution System through Use of System Charges.

Part A: Calculation of Allowed Pass-Through Items (PT)

- 2B.3 For the purposes of Part B of CRC 2A, which establishes the calculation of Allowed Distribution Network Revenue, the total amount of the PT term is calculated in accordance with the following formula (in this condition, the Principal Formula):

$$PT_t = LF_t + RB_t + TB_t - HB_t + SMC_t + SMIT_t + RF_t + SEC_t + UNC_t + SEVEC_t + SNESRC_t$$

- 2B.4 In the Principal Formula:

- LF_t means the licence fee adjustment in Regulatory Year t, as derived in accordance with the formula set out in Part B of this condition.
- RB_t means the Business Rates adjustment in Regulatory Year t, as derived in accordance with the formula set out in Part C of this condition.
- TB_t means the Transmission Connection Point Charges adjustment in Regulatory Year t, as derived in accordance with the formula set out in Part D of this condition.
- HB_t means the amount received by the licensee in Regulatory Year t as the result of any direction given by the Secretary of State in accordance with section 184 of the Energy Act 2004 in relation to assistance for high-cost distributors (see also CRC 2N in connection with this).
- SMC_t means the Smart Meter Communication Licensee Costs adjustment in Regulatory Year t, as derived in accordance with the formula set out in Part E of this condition.
- $SMIT_t$ means the Smart Meter Information Technology Costs adjustment in Regulatory Year t, as derived in accordance with the formula set out in Part F of this condition.
- RF_t means the Ring Fence Costs adjustment in Regulatory Year t, as derived in accordance with Part G of this condition.
- SEC_t means the Shetland Variable Energy Costs, in Regulatory Year t, as derived in accordance with Part H of this condition.

UNCI means an amount in Regulatory Year t representing a relevant adjustment to the calculation of Allowed Demand Revenue arising from the application of CRC 2Q (Arrangements for the recovery of costs for an integrated plan to manage supply and demand on Shetland). Uncertain costs may also be recovered under CRC 3F (Arrangements for the recovery of uncertain costs).

SEVEC_t means the Shetland Extension Variable Energy Costs in Regulatory Year t, as derived in accordance with Part I of this condition.

SNESRC_t means the Shetland New Energy Solution Residual Costs in Regulatory Year t, as derived in accordance with Part J of this condition.

Part B: Calculation of the licence fee adjustment (LF)

2B.5 For the purposes of the Principal Formula, and subject to paragraph 2B.7, LF_t is derived in accordance with the following formula:

$$LF_t = \left(\frac{LFA_{t-2}}{RPIA_{t-2}} - LFE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.6 In the above formula for LF_t:

LFA_{t-2} means the amount of licence fee payments, in Regulatory Year t-2, made by the licensee in accordance with its obligations under standard condition 5 (Licensee's payments to the Authority).

LFE_{t-2} means the amount of the licence fee allowance, in Regulatory Year t-2, and is represented by the amount set out in Appendix 1 of this condition that applies to the licensee.

RPIA_{t-2} has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

RPIF_t has the value given to it by Part C of CRC 2A.

2B.7 In the Regulatory Years 2015/16 and 2016/17, LF_t will have the value of zero.

Part C: Calculation of the Business Rates adjustment (RB)

2B.8 For the purposes of the Principal Formula, and subject to paragraphs 2B.10 and 2B.11, RB_t is derived in accordance with the following formula:

$$RB_t = \left(\frac{RBA_{t-2}}{RPIA_{t-2}} - RBE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.9 In the above formula for RB_t:

RBA_{t-2} means the amount, in Regulatory Year $t-2$, paid by the licensee in respect of Business Rates.

RBE_{t-2} means the amount of the allowance in respect of Business Rates, in Regulatory Year $t-2$, and is represented by the amount set out in Appendix 2 of this condition that applies to the licensee.

$RPIA_{t-2}$ has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

$RPIF_t$ has the value given to it by Part C of CRC 2A.

2B.10 In Regulatory Years 2015/16 and 2016/17, RB_t will have the value of zero.

2B.11 In paragraphs 2B.12 and 2B.13, the relevant valuation agency in England and Wales is the Valuation Office Agency and in Scotland is the Scottish Assessors Association.

2B.12 Paragraphs 2B.13 to 2B.16 apply if the relevant valuation agency revalues any of the licensee's assets for the purposes of setting Business Rates.

2B.13 If, after reviewing the licensee's engagement with the relevant valuation agency with respect to a particular revaluation, the Authority considers that the licensee has not used its reasonable endeavours to minimise the amount of the Business Rates to which it is liable, the Authority may, subject to paragraphs 2B.14 and 2B.15, by Notice to the licensee specify that any positive value for RB_t for one or more Regulatory Years derived under the formula set out in paragraph 2B.8 is to be changed to a different value.

2B.14 A Notice under paragraph 2B.13 is of no effect unless the Authority has first consulted with the licensee.

2B.15 A Notice under paragraph 2B.13:

(a) may not specify a different value for RB_t for the Regulatory Year following the Regulatory Year in which the revaluation took place or for any earlier Regulatory Year; and

(b) may not specify a different value for RB_t that is less than zero.

2B.16 At any time after giving a Notice under paragraph 2B.13, the Authority may by a further Notice to the licensee nullify the original Notice and its effects.

Part D: Calculation of the Transmission Connection Point Charges adjustment (TB)

2B.17 For the purposes of the Principal Formula, and subject to paragraph 2B.19, TB_t is derived in accordance with the following formula:

$$TB_t = \left(\frac{PTPA_{t-2}}{RPIA_{t-2}} - PTPE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.18 In the above formula for TB_t :

$PTPA_{t-2}$ means the amount of Pass-through Transmission Connection Point Charges incurred by the licensee in Regulatory Year t-2.

$PTPE_{t-2}$ means the amount of the Pass-through Transmission Connection Point Charges allowance in Regulatory Year t-2, and is represented by the amount set out in Appendix 3 of this condition that applies to the licensee.

$RPIA_{t-2}$ has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

$RPIF_t$ has the value given to it by Part C of CRC 2A.

2B.19 In the Regulatory Years 2015/16 and 2016/17, TB_t will have the value of zero.

Part E: Calculation of the Smart Meter Communication Licensee Costs adjustment (SMC)

2B.20 For the purposes of the Principal Formula, and subject to paragraph 2B.22, SMC_t is derived in accordance with the following formula:

$$SMC_t = \left(\frac{SMCA_{t-2}}{RPIA_{t-2}} - SMCE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.21 In the above formula for SMC_t :

$SMCA_{t-2}$ means the amount of Smart Meter Communication Licensee Costs incurred by the licensee in Regulatory Year t-2.

$SMCE_{t-2}$ means the amount of the Smart Meter Communication Licensee Costs allowance in Regulatory Year t-2, and is represented by the amount set out in Appendix 4 of this condition that applies to the licensee.

$RPIA_{t-2}$ has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

$RPIF_t$ has the value given to it by Part C of CRC 2A.

2B.22 In the Regulatory Years 2015/16, 2016/17, 2023/24 and 2024/25, SMC_t will have the value of zero.

Part F: Calculation of the Smart Meter Information Technology Costs adjustment (SMIT)

2B.23 For the purposes of the Principal Formula, and subject to paragraph 2B.25, $SMIT_t$ is derived in accordance with the following formula:

$$SMIT_t = \left(\frac{SMIA_{t-2}}{RPIA_{t-2}} - SMIE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t + SMITR_t$$

2B.24 In the above formula for $SMIT_t$:

$SMIA_{t-2}$ means the amount of Smart Meter Information Technology Costs incurred by the licensee in Regulatory Year t-2.

$SMIE_{t-2}$ means the amount of the Smart Meter Information Technology Costs allowance in Regulatory Year t-2, and is represented by the amount set out in Appendix 5 of this condition that applies to the licensee.

$RPIA_{t-2}$ has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

$RPIF_t$ has the value given to it by Part C of CRC 2A.

$SMITR_t$ means the adjustment to Smart Meter Information Technology Costs for the licensee in Regulatory Year t as a result of the SMIT review.

2B.25 In the Regulatory Years 2015/16, 2016/17, 2023/24 and 2024/25, $SMIT_t$ will have the value of zero.

2B.26 In 2020/21, the Authority will commence a review (the “SMIT review”) of the information technology costs that the licensee has incurred or plans to incur, during the Price Control Period, to enable it to use smart metering data for the operation and maintenance of its Distribution System.

2B.27 The SMIT review will determine whether the costs incurred or planned are falling or capable of falling within the definition of Smart Meter Information Technology Costs.

2B.28 Before making the determination referred to in paragraph 2B.27, the Authority will consult with the licensee and any other party that the Authority considers appropriate.

2B.29 A determination under this Part may:

(a) set the value of $SMITR_t$ for any Regulatory Year, subject to paragraph 2B.30; and

(b) impose conditions with respect to the amounts and circumstances in which future costs may be passed through under the $SMIT_t$ term.

2B.30 In the Regulatory Years before 2021/22, SMITR_t will have the value of zero.

Part G: Calculation of the Ring Fence Costs adjustment (RF)

2B.31 For the purposes of the Principal Formula, and subject to paragraph 2B.33, RF_t is derived in accordance with the following formula:

$$RF_t = \left(\frac{RFA_{t-2}}{RPIA_{t-2}} - RFE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.32 In the above formula for RF_t:

RFA_{t-2} means the amount of Ring Fence Costs incurred by the licensee in Regulatory Year t-2.

RFE_{t-2} means the amount of the Ring Fence Costs allowance in Regulatory Year t-2, and is represented by the amount set out in Appendix 6 of this condition that applies to the licensee.

RPIA_{t-2} has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

RPIF_t has the value given to it by Part C of CRC 2A.

2B.33 In the Regulatory Years 2015/16 and 2016/17, RF_t will have the value of zero.

Part H: Calculation of the Shetland Variable Energy Costs adjustment (SEC)

2B.34 For the purposes of the Principal Formula, and subject to paragraph 2B.36, SEC_t is derived in accordance with the following formula:

$$SEC_t = \left(\frac{SECA_{t-2}}{RPIA_{t-2}} - SECE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.35 In the above formula for SEC_t:

SECA_{t-2} means the amount of Shetland Variable Energy Costs incurred by the licensee in Regulatory Year t-2, in accordance with CRC 2P (Shetland Variable Energy Costs Pass-Through Items).

SECE_{t-2} means the amount of Shetland Variable Energy Costs allowance in Regulatory Year t-2, and is represented by the amount set out in Appendix 7 of this condition that applies to the licensee.

RPIA_{t-2} has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

RPIF_t has the value given to it by Part C of CRC 2A.

2B.36 In the Regulatory Years 2015/16 and 2016/17, SEC_t will have the value of zero.

Part I: Calculation of the Shetland Extension Variable Energy Costs (SEVEC_t)

2B.37 For the purposes of the Principal Formula, and subject to paragraph 0, $SEVEC_t$ is derived in accordance with the following formula:

$$SEVEC_t = \left(\frac{SEVECA_{t-2}}{RPIA_{t-2}} - SEVECE_{t-2} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.38 In the above formula for $SEVEC_t$:

$SEVECA_{t-2}$ means the amount of the Shetland Extension Variable Energy Costs incurred by the licensee in Regulatory Year t-2, in accordance with CRC 2R (Shetland Extension Variable Energy Costs Pass-Through Items).

$SEVECE_{t-2}$ means the amount of the Shetland Extension Variable Energy Costs allowance in Regulatory Year t-2, and is represented by the amount set out in Appendix 8 of this condition that applies to the licensee.

$RPIA_{t-2}$ has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

$RPIF_t$ has the value given to it by Part C of CRC 2A.

2B.39 In the Regulatory Years 2015/16, 2016/17, 2017/18 and 2018/19, $SEVEC_t$ will have the value of zero.

Part J: Calculation of the Shetland New Energy Solution Residual Costs (SNESRC)

2B.40 For the purposes of the Principal Formula, and subject to 2B.42, $SNESRC_t$ is derived in accordance with the following formula:

$$SNESRC_t = \left(\frac{SNESRC_{t-2}}{RPIA_{t-2}} \right) \times PVF_{t-2} \times PVF_{t-1} \times RPIF_t$$

2B.41 In the above formula for $SNESRC_t$:

$SNESRC_{t-2}$ means the amount of Shetland New Energy Solution Residual Costs allowance in Regulatory Year t-2, and is represented by the amount set out in Appendix 9 of this condition that applies to the licensee.

$RPIA_{t-2}$ has the value given to it by Part C of CRC 2A.

PVF_t has the value given to it by Part C of CRC 2A.

RPIF_t has the value given to it by Part C of CRC 2A.

2B.42 In the Regulatory Years 2015/16, 2016/17, 2017/18, 2018/19, 2020/21, 2021/22 and 2022/23 SNESRC_t will have the value of zero.

Part K: Interpretation

2B.43 For the purposes of this condition:

Business Rates	means: (a) in England and Wales, the rates payable by the licensee in respect of hereditaments on the Central Rating Lists (England and Wales) compiled under section 52 of the Local Government Finance Act 1988 (or any legislation amending or replacing those enactments); or (b) in Scotland, the rates payable by the licensee in respect of any land and heritages on the Valuation Rolls compiled under the Local Government (Scotland) Act 1975 or the Local Government (Scotland) Act 1994 (or any legislation amending or replacing those enactments).
Elective Communication Services	has the meaning given to that term in the Smart Energy Code.
Pass-through Transmission Connection Point Charges	means those elements of Transmission Connection Point Charges that do not qualify as New Transmission Capacity Charges.
Ring Fence Costs	means the amount of the incremental costs necessarily incurred by the licensee in Regulatory Year t-2 as a direct result of complying with the additional regulatory requirements referred to in the Authority's letter dated 1 February 2013 entitled "Modifications to the ring fence conditions in network operator licences" and published on the Authority's Website, provided that those costs: (a) have been ascertained in accordance with the RIGs referred to in standard condition 46 (Regulatory Instructions and Guidance); and (b) have not been otherwise remunerated under any other provision of this licence.

Smart Energy Code	means the document of that name referred to in standard condition 21A (The Smart Energy Code), that is maintained for the purposes of that condition and is subject to modification pursuant to Condition 23 (Change control for Smart Energy Code), of the Smart Meter Communication Licence.
Smart Meter Communication Licence	means the licences granted under section 6(1A) of the Act and section 7AB(2) of the Gas Act 1986.
Smart Meter Communication Licensee Costs	means charges payable by the licensee (by virtue of the requirement for it to be a party to the Smart Energy Code) to the holder of the Smart Meter Communication Licence in accordance with section J of the Smart Energy Code, excluding any charges in respect of Elective Communication Services.
Smart Meter Information Technology Costs	means any information technology costs that the licensee reasonably incurs that are necessary to enable the licensee to use data from Smart Meters (within the meaning given to that term in Condition 1 of the Smart Meter Communication Licence) effectively for the efficient and economic operation, maintenance and development of its Distribution System, as further clarified in the RIGs.
Shetland Variable Energy Costs	means the pass through items applicable to SSEH as defined in CRC2P (Shetland Variable Energy Costs Pass-Through Items).
Shetland Extension Variable Energy Costs	means the costs arising from the application of CRC 2R (Shetland Extension Variable Energy Costs Pass-Through Items).
Shetland New Energy Solution Residual Costs	means the costs incurred by SSEH as a result of running the Shetland Competitive Process, which are not Shetland Competitive Process Costs.

APPENDIX 3

Values for the PTPE term (£m, 2012/13 prices) by licensee
(see Part D of this condition)

	Regulatory Year							
Licensee	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
SSEH	14.4	14.4	15.1	16.1	17.0	17.7	18.5	18.3

APPENDIX 5

Values for the SMIE term (£m, 2012/13 prices) by licensee
(see Part F of this condition)

	Regulatory Year							
Licensee	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
SSEH	1.1	0.0	0.0	0.0	0.3	0.0	0.0	0.0

APPENDIX 7

Values for the SECE term (£m, 2012/13 prices) by licensee
(see Part H of this condition)

	Regulatory Year							
Licensee	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
SSEH	4.63	4.66	6.05	6.43	0.00	0.00	0.00	0.00

APPENDIX 8

Values for the SEVECE term (£m, 2012/13 prices) by licensee
(see Part I of this condition)

	Regulatory Year							
Licensee	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
SSEH	0.00	0.00	0.00	0.00	X.XX	X.XX	X.XX	X.XX

APPENDIX 9

Values for the SNESRC term (£m, 2012/13 prices) by licensee

(see Part J of this condition)

	Regulatory Year							
Licensee	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
SSEH	0.00	0.00	0.00	0.00	X.XX	0.00	0.00	0.00

CRC 2R. Shetland Extension Variable Energy Costs Pass-Through Items

Introduction

2R.1 This condition sets out the calculation of SEVECA (the Shetland Extension Variable Energy Costs term) that applies in CRC 2B.

2R.2 It does not provide for the Shetland Variable Energy Costs or Shetland Extension Fixed Energy Costs (as defined in Part C of CRC 3F), allowances for which are provided in base revenue. The starting values of the fixed amount allowances are defined in CRC 3F, Appendix 10.

Part A: Calculation of Shetland Extension Variable Energy Costs (SEVECA)

2R.3 The amount of the term SEVECA is derived in accordance with the following formula (in this condition, the Principal Formula):

$$SEVECA_{t-2} = LPSF_{t-2} + EP_{t-2} - SH_{t-2}$$

where:

$LPSF_{t-2}$ has the meaning given in Part A of CRC 2P.

EP_{t-2} has the meaning given in Part A of CRC 2P.

SH_{t-2} has the meaning given in Part A of CRC 2P.

CRC 3F. Arrangements for the recovery of uncertain costs

Introduction

3F.1 This condition establishes a mechanism:

- (a) to specify the basis on which the licensee's opening levels of allowed expenditure on uncertain cost activities, as specified in Table 1, can be revised; and
- (b) to determine any appropriate revisions to PCFM Variable Values for the licensee relating to uncertain cost activities and the Regulatory Years to which they relate, for the purposes of the Annual Iteration Process for the ED1 Price Control Financial Model as described in CRC 4B (Annual Iteration Process for the ED1 Price Control Financial Model).

3F.2 The categories of cost related to uncertain cost activities referred to in this condition and the associated PCFM Variable Values are set out in Table 1 below.

Table 1: Categories of cost related to uncertain cost activities and associated PCFM Variable Values

Category of cost	PCFM Variable Value name
High Value Project Costs	UCHVP values
Enhanced Physical Site Security Costs	UCEPS values
Specified Street Works Costs	UCSSW values
Rail Electrification Costs	UCRE values
Link Box Costs	UCLB values
Shetland Uncertain Energy Costs	UCSFE values
Shetland Competitive Process Costs	UCCPC values
Subsea Cable Costs	UCSC values
Shetland Extension Fixed Energy Costs	UCSEFEC values
Shetland Enduring Solution Process Costs	UCSESPC values

3F.3 The PCFM Variable Value for the licensee, for each uncertain cost activity, for a particular Regulatory Year, revised in accordance with this condition as applicable,

represents the total amount of allowed Totex expenditure (in 2012/13 prices) for that uncertain cost activity for that Regulatory Year.

3F.4 The opening levels of allowed expenditure for the licensee for the categories of cost set out in paragraph 3F.5 for each Regulatory Year, as at 1 April 2015 (that is, before any relevant adjustments have been made under the provisions of this condition), that were used in the calculation of the Opening Base Revenue Allowance for the licensee are set out in the Appendices to this condition shown against each cost category in paragraph 3F.5.

3F.5 The categories of cost and associated appendices referred to in paragraph 3F.4 are:

- (a) High Value Projects Costs – Appendix 1;
- (b) Enhanced Physical Site Security Costs – Appendix 2;
- (c) Shetland Uncertain Energy Costs – Appendix 6;
- (d) Shetland Competitive Process Costs – Appendix 7;
- (e) Shetland Extension Fixed Energy Costs – Appendix 9; and
- (f) Shetland Enduring Solution Process Costs – Appendix 10.

3F.6 The opening level of allowed expenditure for the licensee for the categories of cost set out in paragraph 3F.7 for each Regulatory Year, as at 1 April 2015 (that is, before any relevant adjustments have been made under the provisions of this condition) are respectively zero.

3F.7 The categories of cost referred to in paragraph 3F.6 are:

- (a) Specified Street Works Costs;
- (b) Rail Electrification Costs;
- (c) Link Box Costs; and
- (d) Subsea Cable Costs.

3F.8 This condition should be read and construed in conjunction with CRC 4A (Governance of ED1 Price Control Financial Instruments) and CRC 4B.

Part A: Proposal and determination of relevant adjustments to allowed levels of expenditure on uncertain cost activities

3F.9 This Part provides for:

- (a) the proposal of relevant adjustments by the licensee in respect of all of the cost categories set out in Table 1;
- (b) the proposal of relevant adjustments by the Authority in respect of:
 - (i) High Value Project Costs;
 - (ii) Shetland Uncertain Energy Costs;
 - (iii) Shetland Competitive Process Costs;

- (iv) Shetland Extension Fixed Energy Costs;
- (v) Shetland Enduring Solution Process Costs;
- (c) the determination of relevant adjustments by the Authority; and
- (d) the deeming of relevant adjustments in certain circumstances.

(a) Proposal of relevant adjustments by the licensee

3F.10 The licensee may, by Notice to the Authority, propose a relevant adjustment to the allowed level of expenditure for:

- (a) Regulatory Year 2015/16 to Regulatory Year 2018/19 in respect of:
 - (i) Shetland Uncertain Energy Costs; and
 - (ii) Shetland Competitive Process Costs; and
- (b) any Regulatory Year during the Price Control Period for all other uncertain cost activities set out in Table 1.

3F.11 The licensee may only give Notice of a proposed change to an allowed level of expenditure during the following application windows:

- (a) a window that opens on 1 May 2016 and closes on 31 May 2016, or such later dates as directed by Ofgem, in respect of Subsea Cables Costs;
- (b) a window that opens on 1 May 2017 and closes on 31 May 2017 in respect of:
 - (i) Shetland Uncertain Energy Costs; and
 - (ii) Shetland Competitive Process Costs; and
- (c) a window that opens on 1 July 2017 and closes on 31 July 2017 in respect of Link Box Costs; and
- (d) a window that opens on 1 May 2019 and closes on 31 May 2019 in respect of all other uncertain cost categories.

3F.12 The licensee may give Notice of its intention to make a relevant adjustment in respect of Shetland Extension Fixed Energy Costs and Shetland Enduring Solution Process Costs at the end of the Price Control Period during the window which opens on 1 September 2023 and closes on 30 September 2023.

3F.13 A proposal by the licensee of changes to an allowed expenditure level must comply with the requirements set out in paragraphs 3F.30 and 3F.31.

Authority's power to determine relevant adjustments

3F.14 Where a proposal has been duly made by the licensee under paragraph 3F.10, the Authority will, within four months of the close of the relevant application window, determine any revisions that are to be made to the licensee's allowed level of expenditure for the uncertain cost activities concerned and the Regulatory Years to which those revisions relate, in accordance with the methodologies set out in the following sections of chapter 7 of the ED1 Price Control Financial Handbook:

- (a) Section 2 – in respect of High Value Project Costs;
- (b) Section 3 – in respect of Enhanced Physical Site Security Costs;
- (c) Section 4 – in respect of Specified Street Works Costs;
- (d) Section 5 – in respect of Rail Electrification Costs;
- (e) Section 6 – in respect of Link Box Costs;
- (f) Section 7 – in respect of Shetland Uncertain Energy Costs;
- (g) Section 8 – in respect of Shetland Competitive Process Costs;
- (h) Section 9 – in respect of Subsea Cable Costs;
- (i) Section 10 – in respect of Shetland Extension Fixed Energy Costs;
- (j) Section 11 – in respect of Shetland Enduring Solution Process Costs.

3F.15 If, within 10 working days of receipt of a proposal under paragraph 3F.10, the Authority gives Notice to the licensee:

- (a) specifying any further information or analysis, or reformatting of the information or analysis already provided, that it reasonably considers is required in order to assess the proposal; and
- (b) requesting the licensee to provide that further or reformatted information or analysis,

the application window will be treated as remaining open for the purposes of this Part A until the later of the relevant closing date referred to in paragraph 3F.11 and the date on which such further or reformatted information or analysis is provided.

3F.16 The giving of Notice under paragraph 3F.15 shall not preclude the Authority from making such further requests for information or analysis, or for the reformatting of information or analysis already provided, as it may consider it requires to assess the proposal.

3F.17 In determining any revision under paragraph 3F.14, the Authority will:

- (a) consult with the licensee and other interested parties;
- (b) have regard to the basis on which the opening levels of allowed expenditure for the relevant uncertain cost activities were set for the licensee;
- (c) have regard to comments duly received in response to the consultation conducted under subparagraph 3F.17(a); and
- (d) take no account of the general financial performance of the licensee under the price control arrangements set out in the Charge Restriction Conditions of this licence.

3F.18 A determination under paragraph 3F.14 may confirm, reject, or amend the proposed relevant adjustment.

3F.19 Without limiting the general effect of paragraph 3F.18, a determination by the Authority of a relevant adjustment may specify revisions to the allowed level of

expenditure for the relevant uncertain cost activities for the licensee for any of the Regulatory Years specified in paragraph 3F.10.

- 3F.20 A determination under paragraph 3F.14 will specify:
- (a) the uncertain cost activity that is the subject of the determination;
 - (b) the Regulatory Years to which the determination applies; and
 - (c) the revised total level of allowed expenditure (in 2012/13 prices) for the uncertain cost activity specified under subparagraph 3F.20(a) for each of the Regulatory Years specified under subparagraph 3F.20(b).
- 3F.21 If the Authority has not determined a relevant adjustment in relation to a proposal duly made by the licensee under paragraph 3F.10 within four months of the close of the relevant application window, and the proposal has not been withdrawn, then the relevant adjustment, insofar as it relates to a revision to the allowed level of expenditure on the relevant uncertain cost activities for the licensee for the Regulatory Years specified in the proposal, will be deemed to have been made.

(b) Proposal of relevant adjustments by the Authority

- 3F.22 The Authority may, by Notice to the licensee, propose a relevant adjustment to the allowed level of expenditure for:
- (a) Regulatory Year 2015/16 to Regulatory Year 2018/19 in respect of:
 - (i) Shetland Uncertain Energy Costs; and
 - (ii) Shetland Competitive Process Costs.
 - (b) Regulatory Year 2019/20 to Regulatory Year 2022/23 in respect of Shetland Extension Fixed Energy Costs and Shetland Enduring Solution Process Costs.
 - (c) any Regulatory Year during the Price Control Period for High Value Project Costs.
- 3F.23 The Authority may only give Notice of a proposed change to an allowed level of expenditure during the following windows:
- (a) a window that opens on 1 December 2017 and closes on 31 December 2017 in respect of:
 - (i) Shetland Uncertain Energy Costs; and
 - (ii) Shetland Competitive Process Costs; and
 - (b) a window that opens on 1 December 2023 and closes on 31 December 2023 (which is after the end of the Price Control Period) in respect of High Value Project Costs.
- 3F.24 The Authority may give Notice of its intention to make a relevant adjustment in respect of Shetland Extension Fixed Energy Costs and Shetland Enduring Solution Process Costs at the end of the Price Control Period during the window which opens on 1 September 2023 and closes on 30 September 2023.

3F.25 Where the Authority gives Notice of a proposed relevant adjustment under paragraph 3F.11(e) the Authority will, by 30 November 2024, determine any revisions that are to be made to the licensee's Base Demand Revenue for the next price control period.

3F.26 A proposal by the Authority of changes to an allowed expenditure level must comply with the requirements set out in paragraphs 3F.30 and 3F.31.

Process for determining changes to allowed expenditure levels

3F.27 Before determining any changes to allowed expenditure levels with respect to a proposal it has made under paragraph 3F.22, the Authority will:

- (a) consult with the licensee and other interested parties;
- (b) have regard to the basis on which the opening levels of allowed expenditure for the relevant uncertain cost activities were set for the licensee;
- (c) have regard to comments duly received in response to the consultation conducted under subparagraph 3F.27(a); and
- (d) take no account of the general financial performance of the licensee under the price control arrangements set out in the Charge Restriction Conditions of this licence.

3F.28 A determination by the Authority of a relevant adjustment may specify revisions to the allowed level of expenditure for the relevant uncertain cost activities for the licensee for any of the Regulatory Years specified in paragraph 3F.22.

3F.29 A determination of changes to allowed expenditure levels under paragraph 3F.28 will specify:

- (a) the uncertain cost activity that is the subject of the determination;
- (b) the Regulatory Years to which the determination applies; and
- (c) the revised total level of allowed expenditure (in 2012/13 prices) for the uncertain cost activity specified under subparagraph 3F.29(a) for each of the Regulatory Years specified under subparagraph 3F.29(b).

(c) Requirements relating to all proposals of changes to allowed expenditure

3F.30 A proposed change to an allowed level of expenditure of the type referred to in paragraph 3F.10 or 3F.22 must:

- (a) be based on auditable evidence and justification about the actual or forecast level of efficient expenditure on the uncertain cost activity that was either unavailable or did not qualify for inclusion when the licensee's Opening Base Revenue Allowances were derived;
- (b) take account of any relevant adjustments previously determined under this condition;

- (c) for all uncertain cost activities other than High Value Project Costs constitute a material amount as specified for the licensee in Appendix 2, 3, 4,5, 6, 7, 9 or 10 (as the case may be) to this condition;
- (d) for High Value Project Costs passes the tests set out in Appendix 1;
- (e) relate to costs incurred or expected to be incurred after 1 April 2015; and
- (f) constitute an adjustment to allowed expenditure that (excluding any Time Value of Money Adjustment) cannot be made under the provisions of any other condition of this licence.

3F.31 A proposed change to an allowed level of expenditure of the type referred to in paragraph 3F.10 or 3F.22 must include statements setting out:

- (a) the uncertain cost category to which the proposal relates;
- (b) the changes to the licensee's allowed level of expenditure that are proposed and the Regulatory Years to which those changes relate; and
- (c) the basis of calculation for the changes to the licensee's allowed level of expenditure.

Part B: Procedure to be followed for the determination and direction of revised PCFM Variable Values

3F.32 This Part provides for the determination and direction of revisions to the following PCFM Variable Values for the licensee:

- (a) High Value Project Costs (UCHVP values)
- (b) Enhanced Physical Site Security Costs (UCEPS values);
- (c) Specified Street Works Costs (UCSSW values);
- (d) Rail Electrification Costs (UCRE values);
- (e) Link Box Costs (UCLB values);
- (f) Shetland Uncertain Energy Costs (UCSFE values);
- (g) Shetland Competitive Process Costs (UCCPC values);
- (h) Subsea Cable Costs (UCSC values);
- (i) Shetland Extension Fixed Energy Costs (UCSEFEC values);
- (j) Shetland Enduring Solution Process Costs (UCSESPC values).

3F.33 Determinations under paragraph 3F.32 are to be made in accordance with the provisions of chapter 7 of the ED1 Price Control Financial Handbook.

3F.34 Revised PCFM Variable Values for the licensee, as determined under paragraph 3F.32 will be directed by the Authority by:

- (a) 30 November in Regulatory Year 2016/17 in respect of Subsea Cable Costs or such later date as directed by the Authority;
- (b) 30 November in Regulatory Year 2017/18 in respect of Uncertain Energy Costs and Shetland Competitive Process Costs;
- (c) 30 November in Regulatory Year 2018/19 in respect of Link Box Costs;
- (d) 30 November in Regulatory Year 2019/20 in respect of all other uncertain cost activities; and
- (e) 30 November in Regulatory Year in which the relevant adjustment has been proposed in respect of Shetland Extension Fixed Energy Costs and Shetland Ending Solution Process Costs.

3F.35 A direction under paragraph 3F.34 will be of no effect unless, before issuing it, the Authority has:

- (a) by Notice to the licensee set out all of the revised PCFM Variable Values that it proposes to direct;
- (b) stated in that Notice that those values have been determined in accordance with Part B of this condition;
- (c) specified in the Notice the period (which may not be less than 14 days from the date of the Notice) within which the licensee may make representations to the Authority; and
- (d) considered any representations duly received in response to the Notice.

3F.36 Where the Authority directs any revised PCFM Variable Values for Regulatory Years earlier than Regulatory Year t, the effect of using those revised values in the Annual Iteration Process for the ED1 Price Control Financial Model will, subject to a Time Value of Money Adjustment, be reflected in the calculation of the term MOD for the licensee for Regulatory Year t, and will not have any retroactive effect on a previously directed value of the term MOD.

Part C: Interpretation

3F.37 For the purposes of this condition:

Determination Letter means 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

Enhanced Physical Site Security Costs

means costs incurred, or expected to be incurred, by the licensee for the purposes of implementing any formal recommendation or requirement of the Secretary of State to enhance the physical security of any of the sites within the licensee's Distribution System as may be further clarified in the RIGs.

Link Box

means a low voltage cable marshalling point with facilities for the insertion and removal of linking cables.

Link Box Costs

means costs incurred, or expected to be incurred, by the licensee in efficiently managing the asset risk associated with Link Boxes, as may be further clarified in the RIGs.

Rail Electrification Costs

means costs incurred, or expected to be incurred, other than those recoverable from a third party, associated with the diversion of electric lines or electrical plant to facilitate rail electrification projects approved for funding by the Secretary of State for Transport, as may be further clarified in the RIGs.

Specified Street Works Costs

means the costs incurred, or expected to be incurred, by the licensee in complying with obligations or requirements arising under any order or regulations made under Part 3 of the Traffic Management Act 2004 (or, in Scotland, the Transport (Scotland) Act 2005) that impose a permit scheme, lane rental scheme or equivalent and comprise:

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

all as further clarified in the RIGs.

Shetland Enduring Solution Costs	means the costs incurred, or expected to be incurred, by SSEH in 2019/20, 2020/21, 2021/22 and 2022/23 for identifying and procuring an enduring solution.
Shetland Extension Fixed Energy Costs	means the costs incurred, or expected to be incurred, by SSEH in 2019/20, 2020/21, 2021/22 and 2022/23 for the following: <ul style="list-style-type: none"> (a) third party contracts for Power Purchase Agreements with Sullom Voe Terminal plus/or contingency arrangements (if applicable); (b) capital and operating fixed costs for Lerwick Power Station; and (c) operating costs for the Shetland ANM system.
Shetland Uncertain Energy Costs	means costs incurred, or expected to be incurred by SSEH during the period between 1 April 2015 and the implementation of the enduring solution for Shetland by 2018/19, referred to in the Determination Letter, to the extent that these costs are not otherwise recoverable under the Charge Restriction Conditions of this licence.
Shetland Competitive Process Costs	means the costs incurred, or expected to be incurred by SSEH in 2015/16 in implementing the competitive process referred to in the Determination Letter.
Subsea Cable Costs	means costs incurred, or expected to be incurred, by the licensee in applying recognised and approved measures to protect cables laid on the seabed beyond laying the cable on the seabed and securing it from the low tide mark as the cable emerges from the water in accordance with licensing requirements imposed by Marine Scotland.

APPENDIX 1:

Opening level of allowed expenditure for High Value Project Costs and tests for proposed relevant adjustments for SSEH

(£m, in 2012/13 prices)

(see paragraphs 3F.4 and 3F.30)

Table 1

Opening level of allowed expenditure								
	2015/1 6	2016/1 7	2017/1 8	2018/1 9	2019/2 0	2020/2 1	2021/2 2	2022/2 3
SSEH	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Table 2

	Material Amount	Total opening level of allowed expenditure (TUCHVPOV)
SSEH	4.54	0.00

Tests for proposed relevant adjustments

A proposed relevant adjustment in respect of High Value Project Costs must meet the following tests.

A1.1 The first test is that the following condition must be met:

$$(\max (\text{TUCHVVPF} - \text{TUCHVPOV} , \text{TUCHVPOV} - \text{TUCHVVPF})) > \text{MA} + (20\% \times \text{TUCHVPOV})$$

where:

TUCHVPOV	means the total opening level of allowed expenditure that is defined as High Value Project Costs as set out in Table 2 plus any additional allowed expenditure determined under previous reopeners under this Condition.
TUCHVVPF	means the proposed revised level of allowed expenditure that is defined as High Value Project Costs.
MA	is the material amount set out for the licensee at Table 2 of this Appendix.

A1.2 The second test is that a relevant adjustment to UCHVP values proposed or made under this condition must not exceed:

(i) $\text{TUCHVVPF} - \text{TUCHVPOV} - (20\% \times \text{TUCHVPOV})$

where $\text{TUCHVVPF} > \text{TUCHVPOV}$; or

(ii) $\text{TUCHVVPF} - \text{TUCHVPOV} + (20\% \times \text{TUCHVPOV})$

where $\text{TUCHVVPF} < \text{TUCHVPOV}$

A1.3 In carrying out any calculations pursuant to these tests, allowed and actual expenditure in respect of High Value Project Costs will be considered:

- (a) on an aggregated basis for all activities that comprise High Value Projects;
- (b) on a total expenditure basis taking account of expenditures incurred, or expected to be incurred, over the entire Price Control Period; and
- (c) in 2012/13 prices.

APPENDIX 3:

The material amount for Specified Street Works Costs for SSEH

(£m, in 2012/13 prices)

(see paragraphs 3F.30)

	Material amount
SSEH	4.54

APPENDIX 4:

The material amount for Rail Electrification Costs for SSEH

(£m, in 2012/13 prices)

(see paragraphs 3F.27)

	Material amount
SSEH	4.54

APPENDIX 5:

The material amount for Link Box Costs for SSEH

(£m, in 2012/13 prices)

(see paragraphs 3F.30)

	Material 1 amount
SSEH	4.54

APPENDIX 6:
**Opening level of allowed expenditure for Shetland Uncertain
Energy Costs and the material amount for SSEH**
(£m, in 2012/13 prices)
(See paragraphs 3F.4 and 3F.30)

	Opening level of allowed expenditure								Material amount
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	
SSEH	20.80	21.09	21.27	21.96	0.00	0.00	0.00	0.00	8.51

APPENDIX 8:

The material amount for Subsea Costs for each licensee

(£m, in 2012/13 prices)

(see paragraphs 3F.30)

	Material amount
SSEH	4.54

APPENDIX 9:

**Opening level of allowed expenditure for Shetland Extension Fixed
Energy Costs**

(£m, in 2012/13 prices)

(see paragraphs 3F.4 and 3F.30)

	Opening level of allowed expenditure								Material amount
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	
SSEH	0.00	0.00	0.00	0.00	X.XX	X.XX	X.XX	X.XX	X.XX

APPENDIX 10:
Level of allowed expenditure for Shetland Enduring Solution
Process Costs
(£m, in 2012/13 prices)
(see paragraphs 3F.4 and 3F.30)

	Opening level of allowed expenditure								Material amount
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	
SSEH	0.00	0.00	0.00	0.00	X.XX	X.XX	X.XX	X.XX	X.X