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1. Introduction

- 1.1 Special Condition 2.1 (Revenue restriction) determines the annual Allowed Revenue a licensee can recover in respect of its network business through charges. The RIIO-ED2 Price Control Financial Model (PCFM) is a licence instrument which provides for the calculation of Allowed Revenue. Certain inputs to the ED2 PCFM (the variable values) are updated, resulting in updates to Allowed Revenue within the RIIO-2 Price Control Period.
- 1.2 This handbook sets out how licensees must use the ED2 PCFM to determine Allowed Revenue.
- 1.3 This handbook provides:
 - a) a description of the ED2 PCFM
 - b) The process the licensee must follow in calculating Allowed Revenue
 - c) an overview of the variable values used in the ED2 PCFM during the Annual Iteration Process (AIP); and
 - d) details of how certain variable values are revised or calculated.

Related documents

- 1.4 This handbook is one of several documents relevant to the calculation of Allowed Revenue. Other documents include:
 - a) Special Conditions
 - b) ED2 PCFM
 - c) Associated Documents
 - d) Regulatory Instructions and Guidance including the PCFM Guidance
 - e) Final Determinations
- 1.5 In any case of conflict of meaning between these documents, the following order of precedence applies:
 - a) the relevant licence conditions
 - b) the handbook
 - c) the ED2 PCFM
 - d) Associated Documents including the PCFM Guidance
 - e) Final Determinations.

Document structure

1.6 The remainder of this handbook is structured as follows:

- a) Section 2 provides an overview of the ED2 PCFM and details of the AIP
- b) Section 3 lists the PCFM Variable Values used in the ED2 PCFM and updated through the AIP
- c) subsequent sections provide details of how certain variable values are revised or calculated (along with further details on the ED2 PCFM).

Definitions

1.7 This handbook uses defined terms, which are capitalised throughout this handbook, with the meaning found in the following locations:

- a) the table given below
- b) Special Condition 1.2 (Definitions and references to the Electricity Distributors);
- c) standard condition 1 (Definitions for the standard conditions); and

RIIO-ED2 PCFM	means the ED2 Price Control Financial Model
PCFM Guidance	means the annex of that name to the Regulatory Instructions and Guidance
RIGs	means the Regulatory Instructions and Guidance

2. The ED2 PCFM and Calculation of Allowed Revenue

The Price Control Financial Model

- 2.1 For each Regulatory Year, the ED2 PCFM provides for the calculation of Allowed Revenue in accordance with Special Condition 2.1 (Revenue restriction).
- 2.2 The ED2 PCFM contains both fixed values and a variable values table input area for the licensee. The Allowed Revenue figure for the licensee for each Regulatory Year of the Price Control Period is calculated using the fixed values, the variable values, and the formulae and functions embedded in the ED2 PCFM.
- 2.3 At the outset of the Price Control Period, Allowed Revenue is calculated by the ED2 PCFM, using variable values completed by the Authority in accordance with Final Determinations. From that point, variable values are updated by the licensee in accordance with the relevant licence condition, this handbook, and the PCFM Guidance.

Price base

- 2.4 The ED2 PCFM works in a constant 2020/21 price base, except in respect of some calculations internal to the model that use nominal prices, eg finance, tax and legacy calculations. The use of nominal prices in the ED2 PCFM tax calculations is meant to more accurately reflect the licensee's tax expenses profile in revenue allowance calculations. Where applicable, the row labels in the PCFM will specify the price base of the values in that row.

Temporal convention

- 2.5 The following conventions apply throughout this handbook:
 - a) Relative references: The AR_t term is licensee's Allowed Revenue for each Regulatory Year t during the Price Control Period. References in this handbook to Regulatory Years are made relative to that usage. For example, in the context of AR_t for Regulatory Year 2022/23, a reference in the same context to Regulatory Year $t-1$ would mean 2021/22 and so on
 - b) Absolute references: A reference to, for example, 'the EDE value for 2022/23' means the EDE value in the 2022/23 column of the variable values table for the licensee contained in the ED2 PCFM.

Forecast variable values

- 2.6 In calculating Allowed Revenue, the ED2 PCFM uses some forecast variable values. For example, in the case of expenditure, there is a two-year lag before outturn values can be reflected in Allowed Revenue, and so forecasts are used.
- 2.7 The licensee must submit updates to forecast variable values annually, through the AIP, in accordance with the requirements of the PCFM Guidance. These updates can apply to all Regulatory Years.
- 2.8 For the avoidance of doubt, while a licence condition may refer to actual costs, revenues and outputs, for future periods, the equivalent data should be forecast.

Time value of money

- 2.9 The ED2 PCFM uses a 'time value of money' adjustment to incorporate the financial impact of the timing of cash flows, eg from switching revenues between Regulatory Years as a result of changes to previous Regulatory Years' Allowed Revenue.
- 2.10 [description of TVOM]

Changing the ED2 PCFM

- 2.11 The ED2 PCFM exists as an ED2 Price Control Financial Instrument and, therefore, as a constituent part of Special Condition 8.1, where the process by which the ED2 Price Control Financial Instruments can be modified is also set out in the functionality of the ED2 PCFM
- 2.12 In the event that an error of functionality is discovered in the ED2 PCFM, the following procedure will be followed:
- a) the issue will be considered at the earliest opportunity by the PCFM Working Group (see next section) and a corrective modification will be proposed by Ofgem
 - b) the procedure in Special Condition 8.1 for modifications to the ED2 Price Control Financial Instruments will be followed.

Calculation of Allowed Revenue

- 2.13 In determining the value of Allowed Revenue, the licensee must use the latest version of the ED2 PCFM published on the Authority's Website.
- 2.14 The licensee must update the PCFM Variable Values table at least annually, in accordance with the PCFM Guidance.
- 2.15 The licensee must not make any other modifications to the ED2 Price Control Financial Model beyond the removal of the company input sheets which are not relevant to the licensee, the completion or updating of the PCFM Variable Values table and updating the "UserInterface" tab of the ED2 PCFM.
- 2.16 Where a PCFM Variable Value is not known at the time of calculating Allowed Revenue, the licensee must determine that value in accordance with the ED2 Price Control Financial Handbook or the PCFM Guidance as applicable, and otherwise provide its best estimate using the information available to it at the time.
- 2.17 The licensee must, if it is uncertain of the correct way to calculate a PCFM Variable Value, seek advice from the Ofgem.
- 2.18 Where any PCFM Variable Value relies on a third-party publication that ceases to be published or no longer contains the value required, the value from the most recent publication that did contain the value, or an alternate input agreed to by the Authority must be used.
- 2.19 No less than 14 days prior to the publication of the ED2 PCFM on the licensee's website in accordance with paragraph 2.1.5 of Special Condition 2.1 (Revenue restriction), the licensee must provide the Authority with:
- a) a copy of the ED2 PCFM which the licensee intends to publish on its website;
and
 - b) a commentary describing any changes since the last submission of the ED2 PCFM to the Authority.

In the event that the Authority requires the licensee to change the ED2 PCFM following the provision of the ED2 PCFM to the Authority in accordance with this paragraph, the licensee shall not be required to provide the Authority with a further copy with a 14-day notice period.

- 2.20 The licensee must update the “publication date” label on the “Cover” tab of the ED2 Price Control Financial Model with the date the model was made public on the licensee’s website.
- 2.21 The licensee must use the following file naming convention:
- ED2 PCFM November 20XX
- 2.22 The ED2 Price Control Financial Model will be used for the purpose of determining the value of Allowed Revenue up to and including Regulatory Year 2027/28.

The RIIO-ED2 Price Control Financial Model Working Group

- 2.23 Ofgem will facilitate an industry expert working group to review issues arising with respect to the form or usage of the ED2 PCFM. The terms of reference for The PCFM Working Group (‘the working group’) are set out below.

Terms of reference

Purposes of the working group

- 2.24 The purposes of the working group are:
- a) to review the ongoing effectiveness of the ED2 PCFM in producing a value for Allowed Revenue and capturing financial performance data for each Regulatory Year,
 - b) to provide, when requested by the Authority, its views to the Authority on the impact of any proposed modifications on the ED2 PCFM; and
 - c) to provide such views or recommendations to the Authority with regard to the ED2 PCFM (including as to proposals to modify the ED2 PCFM) as it sees fit.

Composition

- 2.25 The composition of the group will be:
- a) Ofgem (chair)
 - b) Ofgem (secretary); and
 - c) one representative per DNO.

Timing and duration of the group's work

- 2.26 The working group's incumbency will run from 01 April 2023 to 31 March 2028.
- 2.27 The group will meet at least once between 01 January and 01 April during each calendar year, but may meet more frequently if required, in particular in relation to the provision of views on the impact of proposed ED2 PCFM modifications (see paragraph 2.12 2.24b).
- 2.28 In convening any meeting of the working group, Ofgem will give at least 10 working days' notice of the proposed meeting date to the licensee.
- 2.29 Representatives may attend meetings in person or through video or telephone conferencing facilities.
- 2.30 A meeting of the working group will be quorate, for the purpose of expressing a view or recommendation in respect of the ED2 PCFM, when at least one representative from Ofgem, and at least four licensee representatives (each from a different ownership group) are present.

Resources

- 2.31 Meeting facilities will be provided or coordinated by Ofgem. Ofgem will keep notes of key points of discussion and views expressed at meetings, and of any recommendations made by the working group with respect to the ED2 PCFM. A copy of the record of each meeting will be provided to the licensee as soon as is reasonably practicable and to representatives who attended the meeting, and Ofgem will take account of any comments received in finalising the record.

3. The PCFM Variable Values

Types of variable values

Description of input tab categories

List of PCFM variable values

4. Cost of debt and equity indexation

Cost of debt

Cost of equity

5. Real price effects

6. Tax liability allowances

- 6.1 The RIIO-ED2 PCFM calculates a licensee's tax liability allowance on a notional basis (i.e. as a stand-alone entity) using, among other inputs, corporation tax rates and capital allowance writing down rates. Where rate changes are announced, these can be reflected in the RIIO-ED2 PCFM by updating the variable values for these rates (CTt, GCAt, SRCAt, SBCAt and DRCAt) at each AIP.
- 6.2 The RIIO-ED2 PCFM also calculates a tax clawback adjustment¹. Where a licensee's gearing (calculated using the Adjusted Net Debt Variable Value (ANDt) and the closing RAV position uplifted to year-end nominal prices in the RIIO-ED2 PCFM) is greater than the notional gearing level and where its Tax deductible net interest costs (TDNIt) exceed the notional modelled interest costs, the tax benefit derived from its higher tax-deductible interest costs is clawed back and shared with Customers through the RIIO-ED2 PCFM.²
- 6.3 Tax liability allowances are also dependent on other variable values including:
- a) Tax trigger events (TTE) - a licensee's notional tax liability³ is subject to changes in existing legislation, case law, accounting standards and HM Revenue & Customs (HMRC) policy. Changes to these can trigger a change to tax liability allowances;
 - b) Tax allowance adjustment mechanism (TAXAt) – this mechanism enables the Authority to direct an adjustment to the Calculated Tax Allowance following a tax review and having consulted with the licensee;
 - c) Regulatory Capital allowances: Opening pool balances (legacy) – opening balances of capital allowance pools can be revised, through variable values (OGPt, OSRPt, OSBPt, LODRPt and ODRPt). These balances will be rolled forward from the closing position in the RIIO-ED1 PCFM following the close-out of the RIIO-ED1 Period;
 - d) Capital allowances: allocation rates – the RIIO-ED2 PCFM contains the rates that are used to allocate totex to each of the modelled capital allowance pools. These can be revised through variable values (ARGPt, ARSRt, ARSBt, ARDRt, ARRt, ARNQt); and

¹ The tax clawback policy for RIIO-ED2 is to allow networks some headroom as regards the notional gearing level to be used for tax clawback purposes.

² The tax clawback is calculated after the impact of any changes in corporation tax is taken into account.

³ The tax liability which would be modelled if the event was taken into account.

- e) Tax loss brought forward (OTLt) – this represents the opening tax loss balance, which will be rolled forward from the closing position in the RIIO-ED1 PCFM following the close-out of the RIIO-ED1 Period.
- 6.4 All of these tax related PCFM Variable Values (with the exception of the Tax Allowance adjustment term, TAXAt) feed into the Tax Allowance term (TAXt). Both the TAXt and TAXAt terms feed into Calculated Revenue (Rt) as set out in Special Condition 2.1 (Revenue restriction).
- 6.5 Further below, the approach to determining or revising the variable values in paragraph 6.3 and/or the calculation in the RIIO-ED2 PCFM are described further below.
- 6.6 It should be noted that underlying tax liability allowances for the licensee within the RIIO-ED2 PCFM may also change under the AIP because of other variable values, such as changes in allowed totex. However, these changes are distinct from the specific adjustments to tax liability allowances discussed in this chapter.
- 6.7 Any recalculation of the licensee's tax liability allowances necessarily includes an iterative modelling aspect: an increased allowance gives rise to an increased liability which requires an increased allowance and so on. The effect can be either positive or negative. This 'tax allowance on tax allowance' issue is dealt with by the functionality within the RIIO-ED2 PCFM and is factored into Calculated Revenue (Rt) via the AIP.

Regulatory tax losses

- 6.8 In some instances, the approach to calculating tax liability allowances could imply that the licensee could receive a negative allowance. In such cases, the price control treatment is to model a zero allowance and to record the tax loss arising as a 'regulatory tax loss' balance, to be deducted from the total taxable profits before the tax is calculated for any tax liability allowances that would otherwise be allocated to the Regulatory Year concerned or later Regulatory Years. The regulatory tax loss balance attributable to each Regulatory Year (together with a running total) is held within the RIIO-ED2 PCFM.
- 6.9 For the avoidance of doubt, regulatory tax losses are not carried back and offset against tax liability allowances for Regulatory Years earlier than the Regulatory Year to which the regulatory tax loss concerned is attributable.

6.10 Any surrender by a licensee of losses to a group company will not be reflected within the regulatory loss balance and similarly for consortium relief.⁴

Group tax arrangements

6.11 For the purposes of the approach set out in the tax trigger event and tax review sections of this chapter, tax liabilities, allowances and trigger events are considered on a notional 'licensee business' basis. Consequently, the following are disregarded in the assessment of tax liabilities and allowances for price control purposes:

- a) the claim or surrender of group tax relief (including consortium relief);
- b) interest payments (including any coupons on debt instruments or preference share dividends) and receipts that are not tax deductible or chargeable under HMRC rules for the purposes of computing the licensee's taxable profits, including but not limited to adjustments for transfer pricing and the 'Corporate Interest Restriction Rules'; and
- c) any other adjustments required in appendix 1 of Ofgem's open letter dated 31 July 2009 (Claw-back of tax benefit due to excess gearing).⁵

6.12 For the purposes of the approach set out in the tax clawback section of this chapter, levels of debt, interest and gearing are considered at licensee level, as opposed to any other level with respect to the corporate or ownership group of which the licensee is a member.

Accounting framework

6.13 For the purposes of the approach set out in the tax trigger event and tax review sections of this chapter, the accounting framework to be applied by the licensee for the purpose of computing tax liabilities is either:

- a) EU-IFRS, if adopted for use by the licensee;⁶
- b) Financial Reporting Standard 101, EU adopted IFRS with reduced disclosures;
- or
- c) UK GAAP under Financial Reporting Standard 102.

⁴ <https://www.gov.uk/hmrc-internal-manuals/company-taxation-manual/ctm80530>

⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=49&refer=Networks> and as amended for the treatment of hybrid financial instruments

⁶ Including the provisions of IFRS 1 (First-time Adoption of International Financial Reporting Standards) where applicable.

Tax trigger events

- 6.14 The RIIIO-ED2 PCFM allows for changes to a licensee's tax liability allowance, through TTE, for factors exogenous to the licensee, its owners or controllers that cause a change in its notional tax liabilities⁷ for one or more Regulatory Years. These factors exclude changes to the corporation tax rate and writing down allowance rates, which are accounted for with the variable values (CTt, GCAt, SRCAt, SBCAt and DRCAt), but include:
- a) changes to applicable legislation;
 - b) the setting of legal precedents through case law;
 - c) changes to HMRC interpretation of legislation; and
 - d) changes in accounting standards.

Notification of tax trigger events

- 6.15 The licensee must notify Ofgem on or before 30 September in each Regulatory Year t-1 of all the tax trigger events that it has become aware of by that time, except those that have been previously notified. This requirement applies equally to events that could be expected to increase or reduce the licensee's tax liability allowances. For the purpose of complying with this requirement, the licensee must seek to ensure that it identifies and records tax trigger events.
- 6.16 If the licensee fails to notify Ofgem of tax trigger any events of which it becomes aware, or should be aware, then subject to the licensee demonstrating that it uses reasonable endeavours to identify all tax trigger events, this may not be considered a breach of the licence conditions. We will consider each tax trigger event on its merits on a case-by-case basis.
- 6.17 The notification in respect of each tax trigger event should include:
- a) a description of the tax trigger event;
 - b) the changes in tax liability allowances that the tax trigger event is considered to have caused and the Regulatory Years to which they relate;
 - c) the calculations (including all relevant parameters and values) that the licensee used to arrive at the amounts referred to in subparagraph (b) – in performing these calculations the licensee should include a 'tax allowance on

⁷ The tax liability, which would be modelled if the event were taken into account.

- tax allowance' factor as explained in paragraph 6.7 but should ignore the tax trigger deadband;
 - d) any relevant information provided by HMRC in relation to the tax trigger event;
 - e) evidence of mitigating measures that the licensee has taken to minimise any additional liabilities arising from the tax trigger event; and
 - f) comments by the licensee on:
 - (i) the relevance of the tax trigger event to its tax position,
 - (ii) whether grounds exist to contest the applicability of the tax trigger event to the licensee, and
 - (iii) the reporting treatment the licensee expects to apply in its tax submissions to HMRC and in its Regulatory Accounts or statutory accounts where Regulatory Accounts are not prepared.
- 6.18 The licensee's notification should also state whether it considers that the materiality threshold (see paragraph 6.26) has been exceeded for the Regulatory Year(s) concerned, taking into account the total net amount of tax liability changes (upward and downward) included in the current notification and any previous notifications.
- 6.19 Ofgem will review any notifications by the licensee under paragraph 6.15 and may ask the licensee:
- a) for additional information in respect of one or more of the notified events; and/or
 - b) to submit the results of agreed upon audit procedures specified by Ofgem and carried out by the licensee's Appropriate Auditor, to assist in confirming the appropriateness and accuracy of the licensee's calculations.
- 6.20 Ofgem will by 31 October in the same Regulatory Year t-1 inform the licensee whether, in respect of each tax trigger event, it has:
- a) agreed (on a provisional or confirmed basis) the change in tax liabilities figure calculated by the licensee;
 - b) determined (on a provisional or confirmed basis) a different change in tax liabilities figure from that calculated by the licensee; or
 - c) decided that consideration of any change in tax liabilities should be deferred until further/better information is available.

- 6.21 In deciding which of the actions set out in paragraph 6.20 should be taken, Ofgem will consider whether the licensee has conclusively agreed its tax liabilities for the Regulatory Year concerned with HMRC. Where there has been a provisional agreement/determination or a deferral of consideration, the TTE values concerned will be subject to further revision for the purposes of a later AIP.
- 6.22 Where Ofgem decides to use a different change in the tax liabilities figure from that calculated by the licensee or decides that consideration of any change in tax liabilities should be deferred, it will set out its reasons and/or calculations. The licensee has the right to reply setting out its objections, which Ofgem will consider.
- 6.23 Ofgem will also by 31 October in each Regulatory Year t-1 notify the licensee of any tax trigger events that it proposes to take into account that have not been included in a notification sent to Ofgem by the licensee. The licensee has the right to reply setting out its objections, which Ofgem will consider.
- 6.24 If Ofgem has not finished considering any matters raised by the licensee under paragraph 6.22 or paragraph 6.23 before notifying the licensee of tax trigger events that it proposed to take into account, the Authority will through business correspondence, apprise the licensee of any provisionality it has applied in determining the revised TTE values that it proposes to apply, that might entail a further revision to those values for use in the next AIP.
- 6.25 Where a tax trigger event changes the allocation of allowable expenditure into different statutory capital allowance pools, the applicable allocation and allowance rates will be adjusted to take into account the new expected allocation basis from the effective date of the new requirement. Ofgem will work with licensees to agree the financial effect of revised tax pool allocation requirements where these are not straightforward.

Materiality threshold and 'deadband'

- 6.26 A materiality threshold is applied to tax trigger events during the Price Control Period and a £m threshold amount for each Regulatory Year is included among the tax trigger deadband values on the 'Finance & tax' worksheet (Tax trigger calculations section) for the licensee in the RIIO-ED2 PCFM.
- 6.27 A change to the licensee's notional tax liability allowance for a particular Regulatory Year is only applied where one or more trigger events would result in a

tax liability allowance change for that Regulatory Year whose absolute value is greater than the threshold amount. Furthermore, any change to the tax liability allowance (upward or downward) is limited to the amount that is in excess of the threshold amount for the Regulatory Year concerned. Additionally, tax trigger events will only be taken into account for the purposes of increasing the licensee's tax liability allowances where the licensee has demonstrably used its reasonable endeavours to minimise any increase in its tax liabilities.

- 6.28 Where the change to the licensee's tax liability allowance for a particular Regulatory Year is below the threshold, subsequent tax trigger events, relating back to that Regulatory Year, could cause the threshold amount to be exceeded. In that case, a change to the licensee's tax liability allowance for the Regulatory Year concerned (a revised TTE value) would be determined once the threshold had been exceeded.
- 6.29 For the avoidance of doubt, a regulatory tax loss figure attributable to a particular Regulatory Year is not taken into account for the purposes of deciding whether the threshold amount has been exceeded for that Regulatory Year.

Logging of trigger events

- 6.30 Ofgem will keep a log of tax trigger events that have been subject to notifications by it or by the licensee showing for each tax trigger event:
- a) a description of the event;
 - b) the name of the party who notified the event (Ofgem or licensee);
 - c) the date of notification;
 - d) the amount of any change in the licensee's tax liabilities that has been determined; and
 - e) details of any events for which a determination is in abeyance and a description of the outstanding actions to be taken.

Tax review

- 6.31 At the outset of the Price Control Period on 1 April 2023, the value of TAXAt is set at zero for the duration of the Price Control Period. Under Part A of Special Condition 2.2, the licensee's Calculated Tax Allowance can be updated for any periods on or after 1 April 2023 following a tax review. The Authority may consider initiating a tax review if one or more of the events described below occurs.

Potential tax trigger events

6.32 The Authority may consider triggering a tax review in the following scenarios:

- a) if there are material, unexplained differences between the Calculated Tax Allowance and Actual Corporation Tax Liability, which have not been adequately explained in the supporting commentary to the reconciliation⁸;
- b) if Ofgem is notified in writing, whether by the licensee itself or by another stakeholder; or
- c) if a licensee undergoes a material change in circumstances, e.g. a change in ownership, that is likely to affect its actual tax liability.

Materiality

6.33 Under paragraph 6.32, an unexplained difference between the Calculated Tax Allowance and Actual Corporation Tax Liability will be subject to the same materiality threshold that is applied to Tax Trigger Events during the Price Control Period as described in paragraph 6.26 of this handbook. For the avoidance of doubt, an unexplained difference is considered material if it exceeds the threshold described.

6.34 Where there are numerous unexplained differences in the submitted Tax Reconciliation, which are individually immaterial but when taken in aggregate are greater than the materiality threshold amount, Ofgem requires the licensee to provide supporting explanation(s) in the commentary to the Tax Reconciliation.

Notifying the Authority

6.35 Any notification by the licensee under paragraph 6.32(b) must be made in writing to the Authority on or before 31 July in respect of the Regulatory Year two years prior and include statements setting out:

- a) the reason for the notification including a description of the specific event(s) that the licensee considers will have an impact on their Actual Corporation Tax Liability;
- b) the impact of the specific event(s) on the licensee's Actual Corporation Tax Liability and whether it is considered material;

⁸ The reconciliation referred to is the Tax Reconciliation template reconciling the notional tax allowance per the RIIO-ED2 PCFM and actual tax liability per their latest CT600 forms. This template forms part of the licensee's annual RIIO-ED2 PCFM submissions.

- c) the Regulatory Year(s) that the licensee considers will be affected by the event;
 - d) a calculation and the basis of the calculation for any proposed adjustments to the value of the TAXAt term; and
 - e) supporting evidence including any relevant information or correspondence received from HMRC and any other information that the licensee considers is relevant.
- 6.36 Any notification by other stakeholders under paragraph 6.32(b) must be made in writing to the Authority on or before 31 July in respect of the Regulatory Year two years prior and must include as much information as is available to the stakeholder in line with the criteria in paragraph 6.35. Where there are gaps in information, Ofgem will engage with the applicable licensee to ascertain whether the licensee itself should submit a notification under paragraph 6.32(b).
- 6.37 Where Ofgem receives a notification from any stakeholder after 31 July in any Regulatory Year and an adjustment is made following the process outlined in paragraphs 6.39 to 6.47, that adjustment will be made in the subsequent year in the AIP following the direction of the TAXAt term. In such a case, the functionality of the PCFM means that a Time Value of Money Adjustment would be applied.
- 6.38 If an adjustment is made to the TAXAt term for a period prior to the Regulatory Year in which the tax review is triggered, any resultant changes to Allowed Revenue will, subject to a Time Value of Money Adjustment, be brought forward. For the avoidance of doubt, such an adjustment will not have any retrospective effect on a previously published value of Allowed Revenue.

Preliminary assessment

- 6.39 Where one or more of the events set out in paragraph 6.32 occur, Ofgem will perform a preliminary assessment before deciding whether to undertake a tax review.
- 6.40 This preliminary assessment may involve the Authority requesting further information from the affected licensee(s) and from the stakeholder who submitted the notification under 6.32(b) and explaining that it is considering undertaking a tax review.

Review process

- 6.41 If the preliminary information requested does not suitably address the concerns raised, Ofgem may undertake a formal tax review, for which it will procure, at the licensee's expense, a review by an Appropriately Qualified Independent Examiner.
- 6.42 Ofgem will notify the licensee or licensees affected in accordance with Part A of Special Condition 2.2 (Tax allowance adjustment) that it intends to commence the review.
- 6.43 Throughout the course of the review, the licensee will have opportunities to comment on the examiner's findings and engage with both the examiner and Ofgem before the final report is submitted by the examiner to Ofgem.

After the review

- 6.44 Following the review, the Authority will consider the findings of the examiner's report. The Authority will make a direction adjusting the tax allowance through the Variable Value TAXAt in accordance with Part B of Special Condition 2.2 (Tax allowance adjustment) where the examiner's report demonstrates that an adjustment is required to ensure the tax allowance is a fair representation of the licensee's Actual Corporation Tax Liability.
- 6.45 Before making a direction, the Authority will consult on the proposed adjustment to TAXAt for no less than 28 days. s
- 6.46 Where the examiner's report contains information that is considered confidential or market sensitive, the licensee may request that this information be redacted from any publication. Information agreed in writing as being confidential by the Authority will be excluded from any publications.
- 6.47 The adjusted value will be reflected in the RIIO-ED2 PCFM and will be published on the Authority's Website by 30 November in each Regulatory Year.
- 6.48 For the avoidance of doubt, there will be no duplication or double-counting of adjustments between the TAXAt term and the other tax mechanisms that feed into the TAXt term.

Capital allowances

Opening pool balances (legacy)

- 6.49 Tax liability allowance calculations under the AIP make use of regulatory tax pool balance figures held within the PCFM. The opening balances (as at 01 April 2023 for these tax pools may be subject to legacy price control adjustments through revisions to (OGPt, OSRPt, OSBPt, LODRPt and ODRPt) variable values.

7. Pensions

Financial Adjustments - Pensions

7.1 The PCFM contains a Variable Value (EDE) allowance⁹ for Pension Scheme Established Deficit (PSED) repair expenditure for each Regulatory Year of the Price Control Period. Opening values for EDE are based on the outcome of a pension reasonableness review concluded in November 2020. EDE (or the pensions allowance value) will be updated during the Price Control Period, through the AIP, according to the provisions of this chapter.

Expected timing of pensions allowance revisions

7.2 The intention is that pensions allowance values will only be revised periodically in light of triennial actuarial valuations of the relevant pension schemes. Two pension scheme valuations are expected in the RIIO-ED2 price control period, as set out in Table 7.1, with only the first of these expected to result in publication of revised allowances within the period.

Table 7.1 – Expected timetable for pensions scheme valuations

Pension scheme valuation date	Completion of Reasonableness Review	Publication of revised pension allowance value
31 March 2022	31 October 2023 (rr = 2023/24)	30 November 2023
31 March 2025	31 October 2026 (rr = 2026/27)	30 November 2026
31 March 2028	31 October 2029 (rr = 2029/2030)	30 November 2029

7.3 Although the intention is to revise pensions allowance values according to the timetable in Table 7.1, it may be necessary to revise them at different times if, for example, the outcome following any detailed review of an established surplus (see 7.12), or a scheme valuation or completion of a Reasonableness Review (see from paragraph 7.30) is delayed. In those circumstances, pensions allowance values would still be determined in a way that is consistent with the procedures set out in this chapter. The revision of Pensions Allowance values at a different time

⁹ In the context of PSED repair expenditure we refer to 'allowances' rather than 'allowed expenditure' because EDE is included in full in Calculated Revenue (R_t) in the RIIO-ED2 PCFM, ie it is not subject to the TIM.

because of the delayed completion of a Reasonableness Review will not affect the timetable for subsequent reviews of Pensions Allowance referred to in Table 7.1.

7.4 Licensees whose scheme triennial valuation dates differ to those shown in the first column of Table 7.1 will be required to provide either a full valuation or an updated valuation on these dates. The approach that should be used by the licensee to produce an updated valuation is set out in the Authority's Pension Deficit Allocation Methodology, published in the Triennial Pension Reporting Pack as part of the Regulatory Instructions Guidance.

7.5 The remainder of this chapter sets out:

- Section 1: general provisions
- Section 2: the timetable and process for revising pension allowance values, including details of the Reasonableness Review
- Section 3: the calculation of revised pensions allowance values

Section 1 – General provisions

Price control pension principles

7.6 The Authority's price control pension principles are set out in Ofgem's guidance note on price control pension principles under RIIO issued as Appendix 3 to the decision letter, 'Decision on the Authority's policy for funding Pension Scheme Established Deficits' dated 7 April 2017.¹⁰

Pension Scheme Established Deficit

7.7 For the purposes of this chapter:

- a) the term cut-off date refers to the date of 31 March 2010
- b) the term Pension Scheme Established Deficit (PSED), or "established deficit", means an amount derived as the value of the liabilities within a defined benefit pension scheme (or schemes) sponsored (or co-sponsored, eg if part of a group scheme) by the licensee expressed as a positive number, less the corresponding assets, where those assets and liabilities are:
 - (i) attributable to the licensee's distribution business, and

¹⁰ https://www.ofgem.gov.uk/system/files/docs/2017/04/decision_on_policy_for_funding_psed.pdf

(ii) attributable to pensionable service up to and including the cut-off date.¹¹

7.8 The licensee's PSED will be calculated using:

- a) the triennial actuarial valuation of the pension scheme or schemes that contain the PSED described in paragraph 7.7
- b) the allocation of assets and liabilities in the scheme(s) referred to in subparagraph a) to the PSED using the Pension Deficit Allocation Methodology;
- c) the effective date for revised allocations at each triennial actuarial valuation that take effect in the year rr (see Table 7.1); and
- d) the Reasonableness Review with respect to the price control pension principles which could, exceptionally, result in adjustments to the PSED figure on account of errors in methodology or data.

7.9 While the Price Control Period ends on 31 March 2028, Pensions Allowance values will be determined having regard to further PSED repair periods determined under the methodology set out in this chapter (and the associated Price Control Financial Instrument licence condition).

Established surpluses

7.10 The existence of an established surplus indicates that consumers have funded the relevant pension scheme more than it would now appear was necessary. One of the objectives behind our policy is to protect the consumer interest by encouraging strategies that ensure any over-funding can be returned to consumers, where appropriate, and that minimise the risk of a surplus being unrecoverable for consumers or being used, for example to de-risk the scheme, in a way that would not otherwise be in the consumer interest. Strategies may include careful management of deficit funding, the use of asset backed funding arrangements as described from paragraph 7.14, and the use of pension contribution holidays, especially when a scheme still has a significant number of active members. The existence of a surplus does not necessarily mean consumers have overpaid, for example, an efficiently incurred surplus can be effectively used

¹¹ This definition applies even if the value derived is a negative amount (a surplus position) and may be described as an "established surplus".

to de-risk scheme funding in a way that reduces the likelihood of consumers needing to fund future deficits.

- 7.11 In the event that an established surplus arises, it may be appropriate for a licensee and the pension scheme trustees to agree a programme of pension contributions below the level that would otherwise be necessary to fund the accruals of benefits for active members and any deficit relating to post cut-off service. These reduced contributions can be called a contribution holiday. It is important that a pension contribution holiday, to the extent that it is attributable to an established surplus, is returned to consumers.
- 7.12 As part of the Reasonableness Review (see paragraph 7.30) we will conduct an initial review of any established surplus to identify whether a more detailed review is required. This more detailed review would occur as part of the close out of RIIO-2, using the latest information available at that time. The review would take into account the mitigating actions a company has put in place to manage an unnecessary surplus, prevailing and forecast market conditions, the impact of any pension payment holidays (including the timing of those holidays) and the materiality of the surplus. If the review concludes an adjustment is required, it would be applied as part of RIIO-2 close-out.

Pension costs outside the scope of this chapter

- 7.13 The following costs are dealt with as totex in the relevant price control and therefore fall outside the scope of this chapter:
- pension costs associated with employee service after the cut-off date
 - accrued liability costs associated with employee service after the cut-off date (Pension Scheme Incremental Deficit costs), and
 - pension scheme administration costs and Pension Protection Fund levy costs.

Asset-backed funding arrangements

- 7.14 The licensee may choose to enter into asset-backed funding arrangements with pension scheme trustees, either directly or indirectly through related parties. Such arrangements might include a range of alternative funding arrangements, for example, mechanisms involving contingent assets or loan notes benefitting relevant pension schemes.

- 7.15 Any asset-backed funding arrangements must be fully compliant with all conditions, for example relating to the ring fence, in the licensee's licence (except where appropriate consent has been granted under the terms of a condition).
- 7.16 Notwithstanding that an arrangement may be fully compliant with licence conditions, the licensee is encouraged to provide information on any such mechanism or prospective mechanism to the Authority at the earliest opportunity. In general, the Authority would encourage asset-backed funding arrangements that would facilitate the return of funds to consumers in the event that a pension scheme deficit turns out to be smaller than anticipated.
- 7.17 Asset-backed funding arrangements would in general be disregarded in the determination of revised Pensions Allowance values because allowances are provided for PSED repair and not for ancillary arrangements (such as asset-backed funding) per se. However, such arrangements would be relevant in any proposal by the licensee for Pensions Allowance values under the methodology set out in this chapter.

Section 2 – Timetable and process for triennial revision of pensions allowance values

Reasons for updating pensions allowance values

- 7.18 The licensee's pensions allowance values may be revised during the Price Control Period to reflect:
- a) information contained in pension scheme actuarial valuation reports provided by the licensee to the Authority
 - b) the licensee's updated PSED
 - c) information on the history of actual amounts received by the relevant pension scheme(s) in respect of PSED repair payments, attributable to the licensee, submitted to the Authority
 - d) proposals made by the licensee for Base Annual PSED Allowances and payment history allowances
 - e) asset-backed funding arrangements associated with proposals referred to in subparagraph d)
 - f) the outcomes of Reasonableness Reviews (see from paragraph 7.30), and
 - g) any pension contribution holiday attributable in whole or in part to the existence of an established surplus.

Process steps in a year in which a reasonableness review is being conducted¹²

Step 1: by 31 July

- 7.19 The Authority will be in receipt of price control review information from the licensee for Regulatory Years up to and including the last complete Regulatory Year.
- 7.20 The Authority will obtain the licensee's Scheme Valuation Data Set for the relevant valuation of the licensee's defined-benefit pension schemes by 31 July and commence a Reasonableness Review.
- 7.21 The Scheme Valuation Data Set should comprise:
- a) the actuarial valuation of each defined-benefit scheme in respect of which the licensee is a sponsoring employer, being either a full valuation or an update of the last preceding full triennial valuation, with the asset and liability values projected forward to the full valuation date on the basis set out in the Pension Deficit Allocation Methodology¹³
 - b) each scheme's statement of funding principles
 - c) each scheme's statement of investment principles; and
 - d) any other information reasonably required.

Step 2: by 31 August

- 7.22 The licensee will submit:
- a) Explanations and supporting evidence where appropriate for how it has interpreted the interests of consumers to inform its participation in the governance of pension schemes, including setting investment and risk strategies
 - b) Explanation of how it has responded to any recommendations set out by the Authority in preceding Reasonableness Reviews.

¹² Although the intention is to conduct the steps of the reasonableness review according to the dates specified in this section, it may be necessary to change these dates (eg as occurred with the review in 2020, when dates were changed as a consequence of the impacts Covid-19) whilst following the same steps.

¹³ <https://ofgem.gov.uk/publications-and-updates/notice-modify-regulatory-instructions-and-guidance-held-network-operators>

- 7.23 The licensee will also submit Pension Deficit Allocation Methodology information and its PSED figure as at the relevant valuation date indicated in Table 7.1 showing the movements from the previous valuation date.

Step 3: by 14 September

- 7.24 The licensee will submit:

- a) its proposals with supporting explanation for
 - (i) Base Annual PSED Allowances (PBAPAy), under paragraph 7.46
 - (ii) payment history allowances (PPHy), under paragraph 7.52
 - (iii) any proposed prospective discounting basis for payment history variances, reflected in PhDRy, under paragraph 7.52.
- b) explanation of how it has engaged with pension scheme trustees and managers to advocate for the interest of consumers with respect to the PSED.

- 7.25 In its explanations under paragraphs 7.24 7.24b), the licensee should set out why it considers its proposals appropriately protect the interests of consumers. The licensee's explanations should, in each case, where appropriate, refer to the prevailing level of Base Annual PSED Allowances, the profile of repair payments that can be agreed with the scheme trustees, how it has sought to maintain confidence of scheme trustees in the covenant with the licensee in support of such agreement, how it has sought to minimise the risk of stranded surplus, how it has sought to balance the interests of existing and future consumers, how it has sought to manage the volatility of revenues and financial ratios and any asset-backed arrangements that are intended to protect the consumer interest. The licensee's explanations should, where appropriate, refer to or be consistent with information it submitted in accordance with paragraph 7.22.

Step 4: by 30 September

- 7.26 The Authority will provisionally decide whether:

- a) any change should be made to the licensee's proposals for Base Annual PSED Allowances and payment history allowances for reasons anticipated in paragraph 7.32 7.32a) and 7.32b), and 7.33
- b) to apply an existing adjustment factor, introduce a new adjustment factor or extend the scope or effect of an existing adjustment factor for reasons anticipated in paragraph 7.34. Adjustment factor can be either upwards or downwards

- c) to set out any recommendation to the licensee to adopt good practice before the next reasonableness review under paragraph 7.38.

7.27 The Authority will give notice of any such provisional decisions to the licensee, allowing 14 days for representations to be made.

Step 5: by 31 October

7.28 The Authority will complete its Reasonableness Review:

- a) determine the values $BAP A_y$, representing the Base Annual PSED Allowances, for each of the three years following the Reasonableness Review, giving reasons for any departure from those proposed in paragraph 7.46
- b) determine the values PH_y , representing the payment history allowances, for each of the three years following the Reasonableness Review, giving reasons for any departure from those proposed in paragraph 7.52
- c) determine the values AF_y , representing any adjustment factors, for each of the three years following the Reasonableness Review
- d) calculate the Pensions Allowance values for each of the three years following the Reasonableness Review, such that:
$$EDE_y = BAP A_y + PH_y + AF_y$$
- e) set out any recommendation to the licensee to adopt good practice before the next Reasonableness Review
- f) determine the discount rates for payment history allowances, hDR_y , or an unambiguous basis for determining them, for each of the three years following the Reasonableness Review, giving reasons for any departure from those proposed in paragraph 7.52
- g) confirm whether a more detailed review of any established surplus is required (see paragraph 7.12).

Step 6: by 30 November

7.29 The Authority will direct revised Pensions Allowance values and will publish a report on the Reasonableness Review.

Reasonableness Reviews and adjustment factors

7.30 After receiving the whole (or substantially the whole) of the licensee's Scheme Valuation Data Set (see paragraph 7.21) and its proposals for Base Annual PSED Allowances and Payment History Allowances (see paragraph 7.24) in respect of

each defined benefit pension scheme, the Authority will review the way in which the licensee has:

- a) formulated and justified its proposals for Base Annual PSED Allowances and Payment History Allowances
- b) engaged with pension scheme trustees and managers to advocate for the interest of consumers with respect to the PSED, recognising the responsibilities of trustees and the regulatory framework they are subject to, recognising the uncertainties that exist in the PSED valuation and recognising the strength of the employer's covenant
- c) responded to any recommendations set out by the Authority in preceding Reasonableness Reviews
- d) otherwise followed good practice, informed by practice in the regulated and broader private sectors, taking into account statutory and regulatory factors affecting the relevant pension schemes and the specific circumstances of each scheme, in promoting consumer interests with respect to the PSED.

7.31 The review referred to in paragraph 7.30 is termed the Reasonableness Review for the purposes of this methodology.

7.32 Having completed the review, the Authority will consider whether there is any case for:

- a) making corrections to the licensee's calculations in respect of its proposals for Base Annual PSED Allowances and Payment History Allowances due to data or methodological errors
- b) determining Base Annual PSED Allowances and Payment History Allowances with different profiles (while maintaining the same overall prospective values) compared with those proposed by the licensee under paragraphs 7.46 and 7.52
- c) continuing to apply, modifying the scope or modifying the effect of any existing adjustment factors affecting Pensions Allowance values that were put in place following a prior Reasonableness Review
- d) applying any new adjustment factor under paragraph 7.34, and
- e) conducting a more detailed review of any established surplus (see paragraph 7.12).

7.33 The Authority will only make a determination in respect of paragraph 7.32 7.32b) if it considers the licensee's proposals under paragraphs 7.46 and 7.52 do not appropriately protect the interests of consumers, taking into account statutory and

regulatory factors affecting the relevant pension schemes, which may relate to levels of uncertainty in the assumptions adopted in the valuation of the PSED.

7.34 Consistent with its price control pensions Principle 3,¹⁴ the Authority will only apply adjustment factors referred to in paragraph 7.32 7.32c) and 7.32 7.32d) to the extent necessary to disallow any excess costs arising from a material failure in the licensee's responsibility for taking good care of entrusted pension scheme resources on behalf of consumers. New adjustment factors will only arise in the following limited circumstances:

- a) where the Authority has established the licensee's recklessness, negligence, fraud or breach of fiduciary duty towards consumers, such as failures in its participation in the governance of a pension scheme to correct for poor governance or management of the scheme's resources, including any undue risk of a stranded surplus
- b) inequitable charges for consumers arising from using the time value of money in paragraphs **Error! Reference source not found.** and **Error! Reference source not found.** in ascertaining the cumulative payment history variance under paragraph 7.49 for any materially accelerated PSED payments that would otherwise have been determined with reference to the discount rate specified in the licensee's Scheme Valuation Data Set
- c) the licensee's failure to respond adequately to any recommendations set out by the Authority in preceding Reasonableness Reviews.

7.35 Any modification to the effect of existing adjustment factors affecting Pensions Allowance values that were put in place following a prior Reasonableness Review will be made after taking equitable account of the time value of money involved, in general with reference to hDRy.

7.36 Before deciding to make determinations referred to in paragraphs 7.32 7.32b), 7.32 7.32c) and 7.32 7.32d), the Authority will consult with the licensee (see paragraph 7.27), giving its reasons with reference to paragraphs 7.33 and 7.34 and to the Pensions Principles referred to in paragraph 7.6.

7.37 After, considering any representations made by the licensee, the Authority will:

- a) notify the licensee of its decision

¹⁴ See Appendix 3, of https://www.ofgem.gov.uk/system/files/docs/2017/04/decision_on_policy_for_funding_pseeds.pdf

- b) set out the matters, referred to in paragraphs 7.33 and 7.34, that have led to its decision, and
 - c) Set out the basis on which it considers any adjustment factors referred to in 7.32 7.32c) or 7.32 7.32d) might be discontinued at the next Reasonableness Review.
- 7.38 Where, after consulting with the licensee (paragraph 7.27) and giving due weight to the licensee's representations, the Authority considers the licensee is not following good practice which would have the effect of promoting consumer interests with respect to the PSED, the Authority will set out recommendations to the licensee for it to adopt before the next reasonableness review where:
 - a) the Authority considers that adopting the recommendations would not conflict with statutory and regulatory factors affecting the relevant pension schemes
 - b) the Authority has taken into account the relative duties of the licensee and the pension scheme trustees and the extent to which the licensee is only able to influence trustee decisions
 - c) the Authority considers that adopting the recommendations would be in the interests of consumers and would not disproportionately impact the licensee
 - d) the Authority considers it is practical for the licensee to adopt the recommendations.

Section 3 – Proposals for revised pensions allowance values

- 7.39 This section describes what the licensee must take into account in making its proposals for:
 - a) Base Annual PSED Allowances
 - b) payment history allowances.

Base Annual PSED Allowances

- 7.40 Base Annual PSED Allowances represent how consumers will fund the established deficit as evaluated at the last triennial review. The licensee must set out its proposal for Base Annual PSED Allowances after taking account of the following paragraphs.
- 7.41 The licensee must set out its calculations of:

- a) the indicative further PSED repair period, see from paragraph 7.42
- b) the indicative base annual PSED allowance, see from paragraph 7.44 and
- c) its proposal for Base Annual PSED Allowances, see from paragraph 7.46.

Indicative further PSED repair period

7.42 The indicative further PSED repair period represents a number of years (not necessarily a whole number) from the valuation date specified in Table 7.1 and is ascertained by taking the number of years that is the lower of:

- a) the value irp , where irp is calculated using the following formula:

$$irp = \frac{-LN \left(1 - LN(1 + DR) \times \frac{PSED}{EBAPA} \right)}{LN(1 + DR)}$$

where:

PSED is defined in paragraph 7.7 b), expressed in 2020/21 price terms

LN returns the natural logarithm of the value to which it is applied

DR is an annual real (inflation-adjusted) discount rate specified in or justified with reference to the licensee's Scheme Valuation Data Set (established in accordance with Principle 4 - see paragraph 7.6), and

EBAPA is an average of the Base Annual PSED Allowance expressed in 2020/21 price terms for years $rr-1$ and rr , where the year rr is the Regulatory Year specified in Table 7.1 for the relevant Reasonableness Review.

and

- b) 15.

In the event that the PSED is negative, irp is set to zero.

7.43 For example, if the discount rate was 2%, the PSED was £1m and the EBAPA value was £100k, then the Indicative further PSED repair period would be 11.14 years, being the lower of:

- a) 11.14, calculated under the formula at paragraph 7.42 a), and
- b) 15.

Indicative Base Annual PSED Allowance

7.44 The indicative amount for the Base Annual PSED Allowance, IBAPA, is zero if PSED is negative but is otherwise ascertained using the following formula:

$$IBAPA = PSED \frac{LN(1 + DR)}{1 - (1 + DR)^{-irp}}$$

where:

irp is the indicative further PSED repair period ascertained under paragraph 7.42.

7.45 For example, if the PSED was £1m in 2020/21 prices, the Indicative further PSED repair period was 11.14 years, and the discount rate was 2%, the indicative Base Annual PSED Allowance would be £100k. IBAPA will equal EBAPA unless irp is limited to 15.

Proposal for Base Annual PSED Allowances

7.46 Subject to its consideration of the factors set out in subparagraphs (a) to (d) below, the licensee may propose allowances in line with the Indicative Base Annual PSED Allowance calculated under paragraph 7.44. The licensee may propose, with its supporting rationale, an alternative profile of Base Annual PSED Allowances over a repair period that may be shorter or longer than the period determined by paragraph 7.42 if it considers that the indicative Base Annual PSED Allowance calculated by paragraph 7.44 above either:

- a) does not fairly represent a profile of repair payments that can be agreed with the scheme trustees,
- b) following consultation with the Authority, does not appropriately protect the interests of consumers,
- c) derives from an indicative further PSED repair period ascertained under paragraph 7.42 which is less than 5 years, or
- d) is otherwise inappropriate or inequitable.

7.47 The alternative proposal under paragraph 7.46 must represent a profile of Base Annual PSED Allowances, PBAP_y for each year y subsequent to the valuation date specified in Table 7.1, such that

$$\sum_{y \geq rr-1} \frac{PBAP_y(1 + f \cdot DR)}{(1 + DR)^{y+2-rr}} \leq PSED + LO - ABV$$

where:

$$f = \frac{1}{LN(1 + DR)} - \frac{1}{DR}$$

LO means the value of any assets included in the PSED valuation that represent an obligation from the licensee for future payments (or other consideration) to the relevant scheme(s) under an arrangement agreed between the licensee and the scheme(s)

ABV means the value of assets as at the PSED valuation date held under asset-backed arrangements that is fairly attributable to funding by the licensee out of negative cumulative payment history variances (see paragraph 7.49) up to the valuation date and where those assets are available under an agreement with pension scheme trustees only for future funding of an established deficit or for recovery on behalf of consumers, for example in the event that pension surpluses arise. Where relevant, the value should be determined using a methodology for the evaluation of ABV and ABC (see paragraph 7.52) agreed in writing by the Authority at or close to the inception of an arrangement, the Authority giving its reasons why it considers the methodology furthers the interests of consumers. In the absence of any such agreement, the licensee may make its own estimate of the value of ABV, which would have a symmetrical effect on the calculations in paragraph 7.52.

PBAPay for years rr-1 and rr are the Base Annual PSED Allowances determined by the Authority for those years, and

“.” is a symbol for multiply (the mathematical operation of multiplication)

Payment history allowances

7.48 The determination of revisions to Pensions Allowance values for the licensee will include payment history allowances, which may be positive or negative, relating to the cumulative variance between the licensee’s PSED repair payments and its historical allowances for PSED repair prior to the PSED valuation date. The payment history prior to a triennial valuation will affect that valuation, and thus the Base Annual PSED Allowances needed to fund it as described in paragraph 7.40. Payment history allowances ensure that customers are properly compensated if the licensee has, prior to the triennial valuation, paid less in funding the PSED than it has received from consumers, and that companies do not lose out if they have paid more.

7.49 The cumulative pre-valuation payment history variance value at the end of the Reasonableness Review year, V_{rr} , is ascertained using a method permitted by paragraph 7.51 or using the following formula:

$$V_{rr} = LTU + \sum_{y=pco1}^{rr-2} \left(\frac{(D_y - E_y)(1 - CT_y)}{(1 + g_y \cdot hDR_y)(1 - CT_{rr+1})} \prod_{t=y}^{rr} (1 + hDR_t) \right) - \sum_{y=rr-1}^{rr} \left(\frac{PH_y(1 - CT_y)}{(1 + g_y \cdot hDR_y)(1 - CT_{rr+1})} \prod_{t=y}^{rr} (1 + hDR_t) \right)$$

where:

LTU is the legacy true-up value specified in paragraph 7.50, where relevant

pco1 means the first Regulatory Year subsequent to the cut-off date

rr is the Regulatory Year specified in Table 7.1 for the relevant Reasonableness Review

D_y means the net sum of the following, which may be positive or negative, expressed in 2020/21 price terms:

- amounts received by the relevant pension scheme(s) in respect of PSED repair during the course of year y , including amounts received in respect of an obligation accounted for in the LO term in paragraph 7.47
- less any amounts directly or indirectly returned to the licensee or a related undertaking by the relevant pension scheme(s) during the course of year y under an arrangement agreed between the licensee and the scheme(s),
- less the amount by which ongoing pension contributions (for active members) have been reduced on account of an established surplus as described in paragraph 7.11.
- plus any amounts determined by the Authority as advisory fees or other costs relating to the development or implementation of a pensions initiative, eg a contingent asset arrangement, following a review of evidence submitted by the licensee.

PH_y is the payment history allowance determined by the Authority at a preceding Reasonableness Review or price control review, in accordance with paragraph 7.28 or otherwise, and included in the licensee's revenue allowances for year y .

E_y means the licensee's Base Annual PSED Allowances plus payment history allowances, PH_y (which may be positive or negative), included in revenue allowances for the year y

expressed in 2020/21 prices in accordance with paragraph 7.48. Ey excludes any adjustment factor value AF but includes any prior period history allowances included in revenue allowances in the period since pco1 relating to any true-up value in LTU and any other relevant allowances, including contingent asset allowances. With the written agreement of the Authority, the licensee may adjust prior period history allowances to exclude those attributable to legacy true-up values excluded from the LTU term in accordance with paragraph 7.50.

CTy means the actual or, in the case of CTrr+1, prospective rate of Corporation Tax applicable to the licensee in year y

\prod means the product of the series in the brackets for the specified range;

for example:

$$\prod_{t=rr-2}^{rr} (1 + hDR_t) = (1 + hDR_{rr-2})(1 + hDR_{rr-1})(1 + hDR_{rr})$$

hDRy means the discount rate values under any alternative discounting basis determined by the Authority in the relevant reasonableness review for year y (see 7.28 7.28e)) or, where no alternative discounting basis has been specified, the time value of money as described in paragraphs **Error! Reference source not found.** and **Error! Reference source not found.**

$$g_y = \frac{1}{2 + hDR_y}$$

7.50 Where relevant,

- a) Subject to subparagraph b), the legacy true-up value, LTU, represents the present value as at the end of the Reasonableness Review year of any arrangement or arrangements previously agreed or determined by the Authority for the post cut-off true-up of the licensee's pension deficit payment history or true-up of other pension-related costs prior to the cut-off date.
- b) With the Authority's written agreement, the licensee may attribute payment history allowances to legacy true-up values identified in subparagraph a) on a present value neutral basis and exclude both attributable payment history allowances from the calculation of Ey in paragraph 7.49 and the attributable LTU value from the LTU term applied in paragraph 7.49.

- 7.51 The licensee may choose to present a truncated calculation of the term V_{rr} specified in paragraph 7.49, on a basis that is demonstrably consistent with the formula specified in paragraph 7.49. Such a truncated calculation would include cumulative pre-valuation payment history variance values calculated for a previous reasonableness review and rolled forward for payment history variances arising since the valuation date relevant to that earlier review, discount rates and, where relevant, changes in corporation tax rates.
- 7.52 The licensee should propose payment history allowances for future years y , PPH_y , such that:

$$\sum_{y \geq rr+1} \left(PPH_y (1 + h_y \cdot PhDR_y) \prod_{t=rr+1}^y \left(\frac{1}{1 + PhDR_t} \right) \right) \leq V_{rr} + ABC$$

$PhDR_y$ means the discount rate for payment history allowances for year y proposed by the licensee, or the rate forecast for year y according to the licensee's proposed basis of determining discount rates, in either case framed in accordance with paragraph 7.25. Such a proposal may relate $PhDR_y$ to the value of DR , the time value of money or rates of return on asset-backed arrangements. In the absence of any proposal, $PhDR_y$ is the time value of money in period $rr+1$ calculated in accordance with paragraphs **Error!**

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ABC means the deemed present value as at the end of the Reasonableness Review year of the cumulative funding of asset-backed arrangements through negative cumulative payment history variances up to the valuation date and where those assets are available under an agreement with pension scheme trustees only for future funding of an established deficit or for recovery on behalf of consumers, for example in the event that pension surpluses arise. Where relevant, the value should be determined using a methodology for the evaluation of ABV (see paragraph 7.47) and ABC agreed in writing by the Authority at or close to the inception of an arrangement, the Authority giving its reasons why it considers the methodology furthers the interests of consumers. In the absence of any such agreement, ABC should be set at the present value of ABV specified in paragraph 7.47 as at the end of the reasonableness review year, after applying appropriate discount rates (generally hDR_y).

$$h_y = \frac{1}{2 + PhDR_y}$$

8. Legacy adjustments

Overview

8.1 Financial adjustments relating to Regulatory Years falling in RIIO-ED1 fall into two broad categories:

- a) *Legacy inputs from the licensee:* adjustments relating to Special Conditions of this licence as in force on 31 March 2023 that required extending into RIIO-ED2 to account for a lag in the mechanism. These values were previously part of regulatory reporting, but are now calculated in the RIIO-ED2 PCFM in accordance with Special Conditions 7.4, 7.5, 7.6, 7.7 [to be confirmed at once numbering settled]
- b) *Legacy inputs directed by the Authority:* adjustments relating to ED1 Variable Value methodologies and ED1 closeout methodologies, which are implemented in the ED1 Legacy PCFM. The Authority will direct the values of MOD, LRAV, and tax pools to be carried over into the RIIO-ED2 PCFM in accordance with the procedure set out in Special Conditions 7.2 and 7.3.

Legacy inputs from the licensee

8.2 The licensee must populate the RIIO-ED2 PCFM with the inputs required to calculate the legacy adjustments relating to lagged RIIO-ED1 mechanisms, listed in Table 1 below.

Table 1: PCFM Legacy Inputs (part a)

Licence Terms	Special Condition
<i>Broad Measure of Customer Service</i>	
CS	SpC 7.4 Part B
CM	SpC 7.4 Part B
SE	SpC 7.4 Part B
<i>Interruptions-related quality of service incentive revenue adjustment</i>	
QZ	SpC 7.4 Part C
QC	SpC 7.4 Part C
QD	SpC 7.4 Part C
<i>Incentive on Connections Engagement</i>	
ICEO	SpC 7.4 Part D
<i>Time To Connect</i>	

TQA	SpC 7.4 Part E
TQB	SpC 7.4 Part E
TCA	SpC 7.4 Part E
TCB	SpC 7.4 Part E
<i>Licence fee adjustment</i>	
LFA	SpC 7.5 Part B
LFE	SpC 7.5 Part B
<i>Business Rates adjustment</i>	
RBA	SpC 7.5 Part C
RBE	SpC 7.5 Part C
<i>Transmission Connection Point Charges adjustment</i>	
PTPA	SpC 7.5 Part D
PTPE	SpC 7.5 Part D
<i>Smart Meter Communication Licensee Costs adjustment</i>	
SMCA	SpC 7.5 Part E
SMCE	SpC 7.5 Part E
<i>Smart Meter Information Technology Costs adjustment</i>	
SMIA	SpC 7.5 Part F
SMIE	SpC 7.5 Part F
<i>Ring Fence Costs adjustment</i>	
RFA	SpC 7.5 Part G
RFE	SpC 7.5 Part G
<i>Supplier of Last Resort adjustment</i>	
SLRA	SpC 7.5 Part H
<i>Eligible Bad Debt adjustment</i>	
EBDA	SpC 7.5 Part I
RBD	SpC 7.5 Part I
<i>Legacy COVID-19 Bad Debt adjustment</i>	
PCBD	SpC 7.5 Part J
RCBD	SpC 7.5 Part J
CBDA	SpC 7.5 Part J
<i>Shetland Variable Energy Costs adjustment (SSEH only)</i>	
SECA	SpC 7.5 Part K
SECE	SpC 7.5 Part K
<i>Shetland Extension Variable Energy Costs adjustment (SSEH only)</i>	
SEVECA	SpC 7.5 Part L
SEVECE	SpC 7.5 Part L
<i>Shetland New Energy Solution Residual Costs adjustment (SSEH only)</i>	
SNESRCA	SpC 7.5 Part M

SNESRCE	SpC 7.5 Part M
<i>Legacy K correction</i>	
LK	SpC 7.6 Part A
<i>Legacy TRU term</i>	
REV	SpC 7.7 Part A

Legacy inputs directed by the Authority

General Financial Adjustment Methodology¹⁶

- 8.3 The Authority will determine adjustments following the end of the ED1 Price Control Period in accordance with this chapter, and a direction will specify the adjustments the licensee must make in the ED1 Legacy PCFM inputs. The direction will specify an ED1 Variable Value named in the version of this licence as in force on 31 March 2023, or otherwise specify row and column references.
- 8.4 After the Authority has directed values in accordance with paragraph 8.3, and the licensee has provided RIIO-ED1 Variable Value updates from paragraph 8.7, the Authority will take the following steps:
- Ensure the ED1 Legacy PCFM is adjusted in accordance with the methodologies set out in this chapter
 - Ensure "31 Mar 2024" is selected on the "UserInterface tab" of the ED1 Legacy PCFM.
 - Select the relevant licensee "UserInterface tab" of the ED1 Legacy PCFM.
 - Run the "TaxTrigger" macro on the TaxTrigger tab
 - Direct the values on the "Legacy Summary" tab as the corresponding inputs to the ED2 PCFM, set out in Table 2.
- 8.5 The licensee must then populate the RIIO-ED2 PCFM with the inputs directed by the Authority listed in Table 2.
- 8.6 The Authority will not direct the final values for the inputs listed in Table 2 until the conclusion of the component methodologies, set out in Table 3. Until that time, the licensee must use its best estimates.

¹⁶ This methodology has been altered from the Decision on the Closeout Methodologies for RIIO-ED1 (though has the same overall effect), to standardise the calculation of legacy adjustments in the ED2 Legacy PCFM, per ED2 Final Determinations.

Table 2: RIIO-ED2 PCFM Inputs for legacy inputs directed by the Authority

Licence Terms	Special Condition
<i>Legacy MOD</i>	
MOD	SpC 7.2 Part A
<i>Legacy RAV</i>	
LRAV	SpC 7.3 Part A
<i>Legacy Tax Pools</i>	
OGP	SpC 7.3 Part B
OSRP	SpC 7.3 Part B
OSBP	SpC 7.3 Part B
ODRP	SpC 7.3 Part B
LODRP	SpC 7.3 Part B
OTL	SpC 7.3 Part B

RIIO-ED1 Variable Value Methodologies

Revision of ED1 Variable Values

- 8.7 The licensee must use the version of this licence as in force on 31 March 2023 to determine the ED1 Variable Values for the Regulatory Years commencing on 1 April 2021 and 1 April 2022.
- 8.8 The licensee must populate the relevant fields in the ED1 Legacy PCFM.
- 8.9 The ED1 Variable Values may be further adjusted by the closeout methodologies below.

RIIO-ED1 Closeout Methodologies

- 8.10 The following seven sections set out how adjustments to the ED1 Legacy PCFM will be determined. The licensee must then adjust the ED1 Legacy PCFM input as directed in accordance with Table 3 below.
- 8.11 Table 3 lists the adjustments to the ED1 Legacy PCFM that the licensee must make for closeout methodologies, following the General Financial Adjustment Methodology in paragraph 8.3.
- 8.12 Where a Charge Restriction Condition (CRC) is cited in a methodology, it refers to the provisions of this licence as in force on 31 March 2023; however, where the CRC sets out a process for making revenue and RAV adjustments, the licensee will

use the process set out in this handbook instead. These conditions may also refer to definitions within the ED1 Financial Handbook as in force on 31 March 2023.

Table 3: Closeout adjustments in the ED1 Legacy PCFM

Closeout methodology	Relevant ED1 licence reference	ED1 Legacy PCFM input adjusted	Basis for profiling adjustments	Direction Timing
Section 1: Load related expenditure	CRC 3G.20	LRRC	Timing profile of LRRC values	Between 1 September 2023 and 30 September 2023
Section 2: Net to gross adjustment	CRC 5G.14	LRRC	Timing profile of LRRC values	Between 30 November 2023 and 30 November 2024
Section 3: Network asset secondary deliverables	CRC 5D.9 or CRC 5D.11	Non-variant allowed non-load related capex - asset replacement	Timing profile of incurred expenditure	Between 1 December 2023 and 31 December 2023
Section 4: High value projects	CRC 3F.20	UCHVP	Timing profile of Aggregate Baseline Expenditure Allowances	By 30 November 2024
Section 5: Link boxes (SPN and SPMW only)	CRC 3F.20	UCLB	Timing profile of allowances	by 30 November 2024
Section 6: Shetland Extension Fixed Energy Costs (SSEH only)	CRC 3F.26	UCSEFEC	Timing profile of adjustments set out in the determination	by 30 November 2024
Section 6: Shetland Extension Battery Costs (SSEH only)	CRC 3F.26	UCSEBC	Timing profile of adjustments set out in the determination	by 30 November 2024
Section 7: ED1 Shetland Enduring Solution Process Costs adjustments (SSEH only)	CRC 3F.26	UCSESPC	Timing profile of adjustments set out in the determination	by 30 November 2024

8.13 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

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

- 8.14 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.
- 8.15 The methodology that will be followed in evaluating TLRRCF is set out in the Decision on the Closeout Methodologies for RIIO-ED1 Document Annex A: ED1 Load Related Re-opener Closeout Methodology.
- 8.16 If the Authority makes a determination under CRC 3G.20, that determination must be in accordance with CRC 3G.24.
- 8.17 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

- 8.18 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.

Calculation of ED1 Net to Gross adjustment

- 8.19 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.

- 8.20 If the Authority makes a determination under CRC 5G.14, having followed the procedure set out in CRC 5G Part C, the Authority will follow the General Financial Adjustment Methodology in this chapter.

Section 3: ED1 Price Control Period Network Asset Secondary Deliverables (NASD) adjustments

- 8.21 This section sets out the methodology the Authority will follow in determining revisions under CRC 5D in respect of the licensee's delivery of Network Asset Secondary Deliverables (NASD) in the ED1 Price Control Period.
- 8.22 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.
- 8.23 If the Authority makes a determination under CRC 5D.9 or CRC 5D.11, that determination must (i) specify an adjustment to the licensee's "Non-variant allowed non-load related capex - asset replacement" in the ED1 Legacy PCFM, 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 then follow the General Financial Adjustment Methodology in this chapter.
- 8.24 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 8.24(a) by 2.5 and divide by 100 to determine the reward or penalty value.
 - c) Divide the value obtained in 8.24(b) by eight and add it to the adjustment determined in paragraph 8.23.
- 8.25 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.

- 8.26 The Authority will not determine a NASD adjustment for the ED1 Price Control Period before 30 November 2023.
- 8.27 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.
- 8.28 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

- 8.29 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.
- 8.30 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.8¹⁷, after the end of the 2022/23 regulatory year.

HVP Re-opener adjustment

- 8.31 Paragraph 3F.11 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.¹⁸ 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

- 8.32 CRC 3F.8, CRC 3F.9, and Appendix 1 of CRC 3F allow the Authority to determine an adjustment to the allowed level of High Value Project Costs.¹⁹ 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.

¹⁷ For licensees EPN, LPN and SPN. Equivalent CRC 3F paragraph for SSEH is 3F.23

¹⁸ EPN, LPN, SPN: 3F.12. SSEH: 3F.24

¹⁹ EPN, LPN, SPN: 3F.8 AND 3F.10. SSEH: 3F.31 and 3F.32

- 8.33 If the Authority makes a determination under CRC 3F, that determination must specify the revised total level of allowed High Value Project Costs.²⁰ The Authority will follow the General Financial Adjustment Methodology in this chapter.

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

- 8.34 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.
- 8.35 The Authority will use the revised expenditure allowance amounts by 30 November 2024, following the General Financial Adjustment Methodology in this chapter.
- 8.36 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 8.33 for any other purpose.

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

- 8.37 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

- 8.38 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.

²⁰ EPN, LPN, SPN: 3F.21. SSEH: 3F.29

8.39 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 4.

Table 4: Allowed RIIO-ED1 Link Box Replacement Volumes

Licensee	15-16	16-17	17-18	18-19	19-20	20-21	21-22	22-23	RIIO-ED1
SPMW	242	242	449	812	971	1074	1074	1209	6073
SPN	307	1186	625	625	625	625	625	625	5243

- 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 paragraph 8.43, 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 RIIOED1 Link Box Replacement Volumes, no adjustment to allowed expenditure will be made.

8.40 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 5. The Authority will determine the revisions to the UCLB values, then follow the General Financial Adjustment Methodology in this chapter.

Table 5: Unit costs for determining relevant adjustments in respect of RIIOED1 Link Box Replacement Volumes (12/13 prices)

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

- 8.41 If the Authority decides the licensee has delivered its Allowed RIIO-ED1 Link Box Replacement Volumes, no adjustments will be made.
- 8.42 The Authority will check whether the Link Box Closeout materiality threshold has been passed in accordance with paragraph 8.43. If it has not, it will not make a relevant adjustment.

Link Box Closeout materiality threshold

- 8.43 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 6 of this subsection. If the proposed adjustment does not exceed this threshold, then no adjustment will be made.

Table 6: Materiality Threshold for RIIO-ED1 Link Box Replacement Volumes (£m, in 2012/13 prices)

Materiality threshold
0.2

Determination of a relevant adjustment

- 8.44 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.

- 8.45 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.
- 8.46 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.
- 8.47 Subject to paragraph 8.45, no further revisions to the UCLB values for the licensee will be determined after 30 November 2023.

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

- 8.48 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 ED1 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.
- 8.49 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.
- 8.50 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.

8.51 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 8.48. 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 8.63, 8.65 and 8.66. 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.

8.52 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 8.50.

8.53 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

8.54 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 8.63) 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.

- 8.55 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.
- 8.56 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

- 8.57 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 8.48. 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 8.64 to 8.66 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.

8.58 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 8.50.

8.59 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

8.60 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.

- 8.61 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.
- 8.62 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

- 8.63 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.
- 8.64 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.
- 8.65 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.
- 8.66 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

- 8.67 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.
- 8.68 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.
- 8.69 The Authority will follow the General Financial Methodology in this chapter after having determined adjustments determined or deemed to have been made to UCSEFEC and / or UCSEBC values.

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

Overview

- 8.70 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.
- 8.71 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.

8.72 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

8.73 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 8.79 to 8.81. 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.
- 8.74 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 8.72.
- 8.75 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

- 8.76 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 paragraph 8.79) 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.
- 8.77 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.

- 8.78 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

- 8.79 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.
- 8.80 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.
- 8.81 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

- 8.82 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.
- 8.83 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.
- 8.84 The Authority will follow the General Financial Methodology in this chapter after having determined adjustments determined or deemed to have been made to UCSESPC values.

Appendices

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1	Glossary	

Appendix 1 - Glossary

A

B

Base Annual PSED Allowance

See chapter 7, Section 3

C

D

Defined Benefit Scheme

A pension scheme where the benefits that accrue to members are normally based on a set formula taking into account the final salary and accrual of service in the scheme. It is also known as a final salary pension scheme.

E

ENA

Energy Networks Association

Established surpluses

See chapter 7, section 1, para 7.10 - 7.12

F

Final Determinations

Means the suite of documents of that name published on the Authority's Website in relation to the RIIO-ED2 price control.

G

I

L

N

O

P

[Pensions Allowance](#)

See chapter 7, Section 3

[Pension Principles](#)

See Chapter 7, para 7.6

[Pension Scheme Established Deficit \(PSED\)](#)

The difference between assets and liabilities, determined at any point in time, attributable to pensionable service up to the end of the respective Cut-Off Dates and relating to Regulated Business Activities under Pension Principle 2. The term applies equally if there is a subsequent surplus.

Also see chapter 7, para 7.7

R

[Reasonableness Review](#)

See Chapter 7, section 2, from para 7.30

T

Triennial (pension scheme) Valuation

An actuarial valuation of a pension scheme which has been carried out to meet the requirements of Section 224(2)(a) of the Pensions Act 2004 and which results in a written report on scheme assets and liabilities by the scheme actuary. Interim updates to triennial valuations may also be produced.

Also see chapter 7, Section 2

U

Updated Valuation

A report, prepared and signed by the Scheme Actuary, which updates a Triennial Valuation to a later date. This is further defined in the Energy Network Operators' Price Control Pension Costs - Regulatory Instructions and Guidance: Triennial Pension Reporting Pack supplement including pension deficit allocation methodology.