

CROSS SECTOR	
REFERENCE NUMBER:	CATEGORY: Amendment
LICENCE CONDITION NUMBER: (if relevant):	SpC 8.2
TITLE:	GT2 & ET2 PCFM (DRAFT)
RELEVANT LICENCE CONSULTATION QUESTIONS (if any):	Q10, Q11, Q12
RELEVANT ISSUES LOG:	
POLICY ISSUES	
	<p><u>Combining the Revenue RRP and RFPR with PCFM</u></p> <ul style="list-style-type: none"> The calculations used to derive non-totex incentive values should be presented in the PCFM to provide appropriate governance and transparency that the licence algebra has been correctly applied in translating incentive performance to revenue impact. Although the Licence contains the algebra, due to its complex nature, we consider it to be in stakeholders' best interests to include the calculations, in the same way as they were included in the RIIO-1 Revenue RRP, to provide a clear linkage between performance and revenue. The absence of the calculations from the RIIO-2 PCFM will lead Licensees to having offline separate models to calculate such values, undermining the objective of Ofgem streamlining the Revenue RRP into the PCFM. Including the calculations in the PCFM will ensure that all parties are interpreting and applying revenue calculations correctly and consistently. The consultation document states that the PCFM will include all elements of RFPR with the exception of the detailed debt and financing data tables (paragraph 4.25). It is unclear from the information provided in the consultation document whether and how this information will be provided to Ofgem through the reporting process. We therefore request further clarification on this point. <p><u>Capitalisation Rates</u></p> <ul style="list-style-type: none"> We refer to NGET's and NGG's response to RIIO-2 Draft Determinations – Finance Annex FQ23 in which we disagree with the policy used to set the capitalisation rates. Notwithstanding our response, the capitalisation rates employed in the PCFM vary year on year and also differ in magnitude from the fixed annual rates as proposed by Ofgem in RIIO-2 Draft Determinations – Finance Annex Table 40. <p><u>Totex incentive mechanism (Input, Totex and TIM tabs)</u></p>

	<ul style="list-style-type: none"> • The totex incentive mechanism is split between baseline totex and Uncertainty Mechanism (UM) totex. As there is no separate input for UM totex spend within the NGET inputs tab, spend is set to equal allowance for UM's within the TIM tab. The balance of performance between allowances and totex is then allocated to baseline totex. We do not agree with this approach for a number of reasons: <ul style="list-style-type: none"> ○ The resulting baseline and UM performance will be incorrectly stated and misleading to stakeholders. ○ Notwithstanding our views on the determination of the capitalisation rate (reference our response to RIIO-2 Draft Determinations – Finance Annex Q23), incorrect allocation of allowances and expenditure between baseline and uncertainty mechanism categories results in incorrect revenues in a given Regulatory Year due to the differing capitalisation rates as proposed by Ofgem between baseline and Uncertainty Mechanism totex. • The PCFM also includes a Totex performance input value for each form of control. This term is a new introduction and is not described within the consultation document or PCFH and therefore we are not clear what the input is intended to achieve. We do not agree with its introduction as the fixed percentage determines and, if populated overrides the performance on UMs and baseline through amendment of the actual totex expenditure value. This results in incorrect calculation of allowed totex and an error in the calculation of Allowed Revenue. We therefore do not agree with the introduction of the Totex performance input for the following reasons: <ul style="list-style-type: none"> ○ If populated the value results in errors in the calculation of allowed totex, RAV and Allowed Revenue. ○ A single percentage applied across each Regulatory Year is not representative of performance under UMs. ○ Notwithstanding our argument against the introduction of this reporting policy, the application of the Totex performance percentage factor is subject to 2 year lag which is inconsistent with Ofgem's intent to introduce forecasting to the RIIO-2 framework. ○ The Totex performance percentage is standing data and therefore subject to change only through review and agreement of the PCFM Working Group; it is unclear how this value would be determined and agreed. <p>We propose that the PCFM Input tab captures totex expenditure separately for baseline and Uncertainty Mechanism totex categories (this is already the case for NGGT TO). This information can then be used to more accurately calculate the baseline and Uncertainty Mechanism totex expenditure. The allocation of allowances is already provided through the Variable value inputs.</p> • We do not yet have enough information from Ofgem on how the UIOLI mechanism is intended to operate. We therefore require further clarification on this area before we can provide comment on the UIOLI mechanism.
--	---

	<p><u>Tax</u></p> <ul style="list-style-type: none"> • We require confirmation as to whether Capital Allowance pool allocations are also to be variable amounts within the PCFM (alongside tax rates and capital allowance pool rates) and updated as part of the Annual Iteration Process or if these are to remain static for the period of the price control. • There is a change in how the allocation of capex to the capital allowances pools. The RIIO-2 PCFM appears to make the allocation on a total capex basis rather than per type of capex which was applied in the RIIO-1 PCFM. We request that Ofgem advise as to the rationale behind the change. <p><u>Directly Remunerated Services</u></p> <ul style="list-style-type: none"> • We require clear guidance as to how the DRS value (calculated as per SpC 9.7) should be entered into the PCFM, for example in terms of signage. • There is inconsistency in calculation of the Excluded Net Services position within the ET2 and GT2 PCFM Input tabs. The formulae in cells AP397:AT397 in the GT Input tab contains a negative notation in the formulae therefore deducting the cost element. The equivalent formulae in cells AP431:AT431 in the ET Input tab does not contain a negative notation in the formulae so the cost value is essentially added to the revenue. To arrive at the correct Excluded Net Services position, the costs must input as positive values within the GT2 PCFM and negative within the ET2 PCFM. We consider that the inputs should consistent in signage across sectors. Therefore, we require clear instruction as to the signage of the revenue and cost inputs and amendment of the formulae on the Input tabs to show consistent formulae across ET and GT. <p><u>Lack of consistency with Draft Determinations proposals</u></p> <p>The following comment relates to NGET and therefore the ET2 PCFM only:</p> <ul style="list-style-type: none"> • The PCFM currently correctly reflects the Draft Determinations methodology with CoE initially based on a 60% notional gearing assumption which then converts to a 55% geared equivalent assuming the CoE element of WACC does not change with gearing although the calculation does not revisit the individual parameters of the CAPM. Therefore, PCFM requires two gearing inputs; the first for notional gearing for the GT and GD sector and the second for ETO notional gearing. It is not appropriate for an ET PCFM to reference other sectors' RIIO-2 frameworks. Also, GT and GD gearing may ultimately not be set at the 60% working assumption which would potentially result in calculation errors. The 60% value should therefore reference the RIIO-2 working assumption. However, should there be any methodology changes post Draft Determinations, ultimately, the gearing and its inclusion in the CoE calculation should follow the methodology set out in Final Determinations. <p>The following comments relate to NGG and therefore the GT2 PCFM only:</p>
--	---

	<ul style="list-style-type: none"> • There is a single PCFM input value for gearing, labelled as notional gearing. This is in contrast to other sectors' PCFMs (for example, the ET2 PCFM) which reference the gearing working assumption (although we disagree with the notational linkage in the ET2 PCFM to the GT and GD RIIO-2 frameworks) and then adjusts according to the determined notional gearing in accordance with the methodology applied in Draft Determinations. The inputs and treatment of gearing across the PCFMs should be the same for all sectors to reflect the application of the same framework methodologies as set out in Draft Determinations. We propose that the GT2 PCFM gearing and WACC inputs are therefore amended to reflect the proposed methodology with CoE calculated based on the notional gearing assumption and then adjusted for the sector gearing based on a separate term. However, should there be any methodology changes post Draft Determinations, ultimately, the gearing and its inclusion in the CoE calculation should follow the methodology set out in Final Determinations. • The GTO and GSO have separate inputs for the TMR term although the value is expected to be the same for each form of control and Draft Determinations refers to a single TMR value for the Gas Transmission licensee. A single area of common inputs and calculations for the GTO and GSO would be aligned with the Draft Determinations approach as well as improving efficiency of process and reducing potential for manual error.
DRAFTING Issues	
	<p><u>Labelling/formatting issues within PCFM</u></p> <ul style="list-style-type: none"> • The term 'Excluded Services' is used throughout the PCFM, this should be changed to 'Directly Remunerated Services' to reflect the licence drafting. • Several references are made to terms which are not applicable within RIIO-2, for example, recalculated base revenue, true, MOD and RPIF. These require removal or amendment. • The innovation revenue term in the ET & GT PCFM is referred to as 'INNT' instead of 'INNVt' (Revenue tab, cell H20) • All financial parameter inputs items should be quoted to 3 decimal places. This includes cost of debt, cost of equity and inflation indices. <p><u>RPI/CPI</u></p> <ul style="list-style-type: none"> • The values of RPI and CPIH for 2019/20 require updating to reflect actual data. These cells should then be coloured grey to reflect that these are no longer input cells. <p><u>Tax</u></p> <ul style="list-style-type: none"> • Within the Finance&Tax tab, the values within the Tax clawback are converted to a nominal price base. However, the conversion factor is a hardcoded value which has been incorrectly input. The inflation factors required to convert 18/19 price base values to nominal should not be hardcoded and should use the TOPf conversion factor.

- The tax trigger has a deadband applied. This number is a hard coded within the Input tab. We do not have any visibility as to how the deadband has been calculated and are unable to replicate the calculations. We require further detail as to the calculations underpinning the deadband entry. We also expect consistent percentages to be used across the sectors.
- The calculation of the Structures and Buildings Allowance in row 79 of the 'Tax Pools' tab is incorrect. The calculation ignores the current year expenditure allocated to this pool and therefore needs to be updated to include current year additions.
- The Tax allowance calculation is impacted by the value of fixed and index-linked interest deducted in calculating the Profits attributable to corporation tax. The fixed interest value is calculated by inflating the real cost of debt value by the Forecast Debt inflation (CPIH long term assumption), row 32 of the Inputs tab. However, the values included with the Forecast Debt inflation (CPIH long term assumption) are set equal to the RPI-CPIH inflation (simple average year to March) for 2025/26 in row 28 of the Inputs tab. The value in 2025/26 does not equate to the OBR 5-year forecast value for the duration of the price control period. In order to maintain a long-term assumption for CPIH across the period, this value will need to be updated for the forthcoming and subsequent Regulatory Years at each Annual Iteration Process. As such long-term CPIH assumption should be included as a Variable Value input on the NGET tab and the process for completion detailed within the PCFH.

Totex Allowances

- The formula in NGET's Actual totex for UM's on the TIM tab is linked to the uncertain non-load projects re-openers. In the GT2 PCFM the linkage is to the resilience re-opener (UIOLI). We require further clarification on the purpose of these adjustments and assume they should be aligned and consistent across the sectors.

The following comments are in relation to NGET and therefore the ET2 PCFM only:

- The allowance and incentive performance inputs references do not align to licence drafting. Examples are shown below:
 - The Demand PCD term requires correction from DRIt to DSIt to align with the licence drafting.
 - The SpC reference for the Demand Related Infrastructure volume driver DRIt requires correction from SpC 3.23 to SpC 3.19 to align with the licence drafting.
 - The SpC reference for the Large Onshore Transmission Investment Re-opener LOTIt requires correction from SpC 3.19 to SpC 3.20 to align with the licence drafting.
 - The SpC reference for the Medium sized investment projects Re-opener MSIPt requires correction from SpC 3.20 to SpC 3.21 to align with the licence drafting.

	<ul style="list-style-type: none"> ○ The SpC reference for the Pre-construction funding Re-opener PCFt requires correction from SpC 3.21 to SpC 3.22 to align with the licence drafting. ○ The SpC reference for the Subsea cable Re-opener SCRT requires correction from SpC 3.22 to SpC 3.23 to align with the licence drafting. ○ SpC 3.4 defines a Physical Security Re-opener and Price Control Deliverable PSUPT allowance. There are no blue box input within the PCFM variable values table clearly assigned to these allowance inputs. ○ SpC 3.25 defines a Consumer Value Proposition CVPt allowance. There is no blue box input within the PCFM variable values table clearly assigned to this allowance input. ○ The SpC reference for the Energy not supplied output delivery incentive requires correction from SpC 4A to SpC 4.2 to align with the licence drafting. ○ The SpC reference for the Insulation and Interruption Gas emissions output delivery incentive requires correction from SpC 4B to SpC 4.3 to align with the licence drafting. ○ The SpC reference for the Timely Connections output delivery incentive requires correction from SpC 4C to SpC 4.4 to align with the licence drafting. ○ The licence defines the passthrough term, PTt (SpC 6.1.3), as $PT_t = RB_t + EDE_t + TPD_t + CPMR_t + SHCP_t$. Only the RBt and EDEt terms are captured as separate blue box variable inputs within the PCFM. The other terms are potentially captured within “Other Pass Through costs” (row 61). We consider the remaining terms should be input as individual variable input items. ○ There are no specific blue box Variable Value inputs for a Cyber resilience operational technology Re-opener and Price Control Deliverable CROTt (SpC 3.2) or Cyber resilience information technology Re-opener and Price Control Deliverable CRITt (SpC 3.3). However, there are a number of input boxes for resilience. These resilience inputs are not specifically reference to a licence condition or algebraic term, therefore we cannot assess whether they are treated correctly in the PCFM. ○ It is unclear how the PCFM interfaces with those Totex Allowance terms within the licence which include both PCD and re-opener elements. The licence states that any re-opener will result in an update to the appendix that feeds into the formula for calculating PCD element. We require further explanation from Ofgem as to how this mechanism will work in practice without causing circularity of calculation. Without sight of the PCFM Guidance document, it is also unclear how PCDs work with regards to baseline allowances i.e. in the blue box inputs is it the incremental change we are required to enter or the full allowance amount. This additional information is required before we assess whether the inclusion of the separate elements as individual Variable Values and their treatment through the TIM mechanism within the PCFM will be compatible with the allowance calculations. ○ It is not clear on why there are separate input boxes for legacy MODs, but not for other legacy items from the LAR licence condition i.e no input for, LPT, LK, LTRU, NOCO, LSSO, LSFI, LRIt. The individual terms which make up LAR should all have separate variable value inputs within the PCFM.
--	--

	<ul style="list-style-type: none"> ○ The 'RIIO-2 Network Innovation Allowance' (row 63) does not clearly align with the INNVt term as per licence condition SpC 5.1. The use of RIIO-2 to describe the input is also ambiguous as it is unclear whether this refers to the innovation allowance (INNVt) in full or only the RIIO-2 element of the total allowance (NIAt). ○ It is unclear how the input 'RIIO-2 legacy price control adjustments to RAV' aligns with the licence drafting. <ul style="list-style-type: none"> ● Standing data within the PCFM is incomplete or incorrect: <ul style="list-style-type: none"> ○ The BPI input to the PCFM standing data represents the post-tax value. The BPI penalty input to the PCFM standing data is -£64.9m which results in a tax allowance adjustment of -£15.2m. Neither the post tax input value nor the pre-tax Calculated Revenue stream replicate the BPI value included in Table 15 of the RIIO-2 Draft Determinations – Core Document of -£66.6m. We therefore require further explanation as to the intended pre- or post-tax nature of the BPI value and the appropriate pre- or post tax value to be aligned with the Core Document value or further clarification as to the reason for the difference. ○ The Variant allowances totex allocation percentages are required to include percentage allocation across the totex categories for all PCDs and Uncertainty Mechanisms. In the current version of the PCFM, some of these allocation percentages have not been included. ○ There is no section within Variant allowances totex allocation percentages relating to percentage allocations across the totex categories for the Opex Escalator Uncertainty Mechanism. ○ The standing data for non-variant allowance values (rows 161 – 166) currently references calculations based on hidden cells. We assume that these values will simply be inputs rather than calculations to align with the final RIIO-2 framework. ● Certain sections of the licence are yet to be drafted and so the accuracy and completeness of the PCFM cannot yet be confirmed: <ul style="list-style-type: none"> ○ Chapter 8 of the PCFH which covers the submission of legacy items has yet to be drafted. Therefore, we cannot comment on the methodology used to calculate the legacy RAV adjustment term or the process by which the term is included within the PCFM. ○ There is a blue box input variable value input for 'Opex Escalator indexation Re-Opener'. However, the licence does not yet include drafting for this term. ○ The PCFM includes an input for a common ODI termed "Quality of connections survey". However, this does not feature in the algebraic definition of ODIt in SpC 4.1.2 and is not detailed as a NGET ODI within the licence. ○ Special Condition 3.16 Net Zero Fund Price Control Deliverable (NZFt) is included in INNVt within the PCFM. However, the licence states this term should feed into totex. We note that the PCFM treatment of this UIOLI NZFt term is also inconsistent with the treatment of resilience UIOLI allowances. We require further drafting and clarification of the intended UIOLI mechanism to fully assess the treatment of these items.
--	---

- References to RIIO1 Licence conditions which require updating to the RIIO-2 equivalents:
 - EDE references licence condition 6D from RIIO1 Licence which ceases to exist in RIIO2 licence, this should reference 6.1.3.
 - TTE references 6D which ceases to exist in RIIO2 licence.
 - 'Tax Allowance adjustment' has no licence reference or term, this should reference SpC 2.4 (TAXA).
 - 'Allowed percentage cost of debt (NGET and SPT)' has no licence term this should reference CDE.
 - Totex spend blue box inputs (ALC, ARC, AOC etc) reference 6C from the RIIO1 Licence which ceases to exit.

The following comments are in relation to NGG and therefore the GT2 PCFM only:

Input tab

- The formulae in cells AP115:AT120 do not include all of the relevant PCD/UM data. Currently the data in rows 370-375 is excluded; the formulae requires extension to include this data.

NGGT TO tab

- The allowance and incentive performance inputs references do not align to licence drafting. Examples are shown below:
 - There is no clear reference to a PCD variable input which corresponds to SpC 3.2 Cyber Resilience operational technology Re-opener and Price Control Deliverable (CROTt) allowances.
 - There is no clear reference to a PCD variable input which corresponds to SpC 3.3 Cyber Resilience information technology Re-opener and Price Control Deliverable (CRITt) allowances.
 - SpC 3.11 defines both Price Control Deliverable and Reopener elements of the Funded incremental Obligated capacity allowance. However, there is no blue box variable input for PCD element which is inconsistent with the PCFM inputs for other combined Reopener/PCD SpCs.
 - There are no specific blue box Variable Value inputs for a Cyber resilience operational technology Re-opener and Price Control Deliverable CROTt (SpC 3.2) or Cyber resilience information technology Re-opener and Price Control Deliverable CRITt (SpC 3.3). However, there are a number of input boxes for resilience. These resilience inputs are not specifically reference to a licence condition or algebraic term, therefore we cannot assess whether they are treated correctly in the PCFM.
 - It is unclear how the PCFM interfaces with those Totex Allowance terms within the licence which include both PCD and re-opener elements. The licence states that any re-opener will result in an update to the appendix that feeds into the formula for calculating PCD element. We require further explanation from Ofgem as to how this mechanism will work in practice without causing circularity of calculation. Without sight of the PCFM

	<p>Guidance document, it is also unclear how PCDs work with regards to baseline allowances i.e. in the blue box inputs is it the incremental change we are required to enter or the full allowance amount. This additional information is required before we assess whether the inclusion of the separate elements as individual Variable Values and their treatment through the TIM mechanism within the PCFM will be compatible with the allowance calculations.</p> <ul style="list-style-type: none"> ○ The 'Network Innovation Allowance' (row 65) does not clearly align with the INNVt licence term in SpC. 5.1. ○ The blue box input referred to as 'Replacement innovation pot for NIC' does not correspond with any condition within the licence drafting. ○ The licence defines the passthrough term, $TOPT_t$ (SpC 6.1.3), as $TOPT_t = RB_t + LF_t + EDE_t + BD_t + OPTC_t + IS_t + PTV_t$. Only the RB_t, LF_t and EDE_t terms are captured as separate blue box variable inputs within the PCFM. The other terms are potentially captured within "Other Pass Through costs" (row 63). We consider the remaining terms should be input as individual items. ○ There is no input for the Environmental score card ODI (SpC4.3) there is a generic input box for 'bespoke ODIs', we suggest incentives are labelled and input separately, and the calculations are included within the PCFM as mentioned above. ○ It is not clear on why there are separate input boxes for legacy MODs, but not for other legacy items from the LAR licence condition i.e no input for, LPT, LK, LTRU, NOCO, NICF, SSCO. The individual terms which make up LAR should all have separate variable value inputs within the PCFM. ○ It is unclear how the input 'RIIO-2 legacy price control adjustments to RAV' aligns with the licence drafting. <ul style="list-style-type: none"> ● Standing data within the PCFM is incomplete: <ul style="list-style-type: none"> ○ The BPI input to the PCFM standing data represents the post-tax value. The BPI penalty input to the PCFM standing data is -£21.1m which results in a tax allowance adjustment of -£4.9m. Neither the post tax input value nor the pre-tax Calculated Revenue stream replicate the BPI value included in Table 15 of the RIIO-2 Draft Determinations – Core Document of -£26.4m. We therefore require further explanation as to the intended pre- or post-tax nature of the BPI value and the appropriate pre- or post tax value to be aligned with the Core Document value or further clarification as to the reason for the difference. ○ The Variant allowances totex allocation percentages are required to include percentage allocation across the totex categories for all PCDs and Uncertainty Mechanisms. In the current version of the PCFM, some of these allocation percentages have not been included. ○ The standing data for non-variant allowance values (rows 157 – 162) currently references calculations based on hidden cells. We assume that these values will simply be inputs rather than calculations to align with the final RIIO-2 framework.
--	---

	<ul style="list-style-type: none"> • Certain sections of the licence are yet to be drafted and so the accuracy and completeness of the PCFM cannot yet be confirmed: <ul style="list-style-type: none"> ○ Chapter 8 of the PCFH which covers the submission of legacy items has yet to be drafted. Therefore, we cannot comment on the methodology used to calculate the legacy RAV adjustment term or the process by which the term is included within the PCFM. ○ There is a blue box input variable value input for 'Opex Escalator indexation Re-Opener'. However, the licence does not yet include drafting for this term. Also note that 'Escalator' requires correction to Escalator. • References to RIIO1 Licence conditions which require updating to the RIIO-2 equivalents: <ul style="list-style-type: none"> ○ EDE references licence condition 5C which ceases to exist in RIIO2 licence, this should reference 6.1.3. ○ TTE references 5C which ceases to exist in RIIO2 licence. ○ 'Tax Allowance adjustment' has no licence reference or term, this should reference SpC 2.4 (TAXA). ○ CDE references 5C which ceases to exist in RIIO2 licence, this now sits in the PCFH. ○ Spend blue box inputs (ALC, ARC, AOC etc) reference 5B from the RIIO1 Licence which ceases to exit. <p><u>NGGT SO tab</u></p> <ul style="list-style-type: none"> • The allowance and incentive performance inputs references do not align to licence drafting. Examples are shown below: <ul style="list-style-type: none"> ○ The reference terms for the components of Calculated Revenue do not align with those in SpC 2.5 paragraph 2.5.7. ○ The Variable value Pass Through items do not align with the term in the licence drafting (SpC 6.3.3). The PCFM includes inputs for constraint management, transportation support services and pension scheme established deficit. The licence condition includes only CDSP costs. Both the licence and the PCFM should contain the full suite of costs which comprise the calculation of SO Pass Through costs (SOPTt). These include CDSP costs, pension scheme established deficit and System Operator bad debt with constraint management costs forming a separate term which flows through to SO Allowed Revenue but is not included within the definition of SOPTt. ○ The Operating Margins, Basic Net Neutrality and System Costs (SpC 4.5.3) are not included as Variable value blue box inputs and therefore do not flow through to SO Allowed Revenue within the PCFM. The SystemOperator tab also requires amendment to include these terms. ○ It is not clear on why there are separate input boxes for legacy MODs, but not for other legacy items from the SOLAR licence condition i.e no input for SOLK, SOLTRU, LCM. The individual terms which make up LAR should all have separate variable value inputs within the PCFM. ○ It is unclear how the input 'RIIO-2 legacy price control adjustments to RAV' aligns with the licence drafting.
--	---

	<ul style="list-style-type: none"> ○ Within the SystemOperator tab, the placeholder for Innovation (row 188) should be included on the NGGT SO tab consistent with the treatment of all other Variable value blue box inputs. • Standing data within the PCFM is incomplete: <ul style="list-style-type: none"> ○ The standing data for non-variant allowance values (rows 116 – 117) currently references calculations based on hidden cells. We assume that these values will simply be inputs rather than calculations to align with the final RIIO-2 framework. • References to RIIO1 Licence conditions <ul style="list-style-type: none"> ○ SOEDE reference licence condition 6C which ceases to exist in RIIO2 licence ○ SOTTE references 6C which ceases to exist in RIIO2 licence ○ 'Tax Allowance adjustment' has no licence reference or term, this should reference SpC 2.8 (SOTAXA) ○ CDE references 6C which ceases to exist in RIIO2 licence, this now sits in the PCFH ○ Spend blue box inputs (SOANC, SOACO) reference 6B from the RIIO1 Licence which ceases to exit
FINANCE ISSUES	
	<p><u>ET2 PCFM AT tab and GT2 PCFM AR (TO) and AR (SO) tabs</u></p> <ul style="list-style-type: none"> • The following comment applies to both the ADJ and SOADJ terms. However, for brevity, it is described only from the perspective of the ADJ calculation. <p>The ADJ term calculates the revenue impact in prior years relating to updated delivery and performance. The principle revenue formula then incorporates this revenue adjustment into the Allowed Revenue calculation.</p> <p>We understand that the intent is to calculate prior year revenue impact by comparison of the Calculated Revenue in a particular Regulatory Year with the Calculated Revenue in the previous iteration of the PCFM.</p> <p>The error in calculation arises due to the definition of the Calculated Revenue as per the previous iteration of the PCFM (ADJR). Special Condition 2.2 Part B paragraph 2.2.4 defines that Calculated Revenue “<i>for Regulatory Year t, as of the AIP publication in Regulatory Year t-1</i>”. The reference to the publication in Regulatory Year t-1 is both confusing and incorrect. The Annual Iteration Process used to calculate Allowed Revenue for Regulatory Year t, will occur in year t-1. For example, the Allowed Revenue for Regulatory Year 2023/24 is calculated through the November 2022 Annual Iteration Process. Therefore, application of the t-1 Regulatory Year to refer to a previously published revenue results in use of the Calculated Revenue within the current PCFM as a comparative figure. Therefore, the ADJ term will always be zero as the comparative revenue is the same values (from the same iteration of the PCFM) as the current revenue for a</p>

	<p>given Regulatory Year. The PCFM does not align with this algebra and assumes that the comparative revenue term is taken from the previous publication of the PCFM.</p> <p>In order to align the licence with the PCFM treatment, amendment is required to the licence algebra. We appreciate that Ofgem has chosen to use a single term, Regulatory Year, to reference time bound calculations. If Ofgem prefer not to use an alternative definition to reference the year in which the Annual Iteration Process is carried out, we suggest reversion to wording in line with the RIIO-T1 framework which referred to prior year revenue changes as a result of updating the PCFM as the incremental change for year t.</p> <ul style="list-style-type: none"> • The following comment applies to both the ADJ and SOADJ terms. However, for brevity, it is described only from the perspective of the ADJ calculation. <p>Even correcting for the error noted in the previous section, the ADJ term still requires further revision to correctly reflect the magnitude and direction of adjustments to historic revenues.</p> <p>We have identified a further error within the calculation of the ADJR term (Special Condition 2.2 Part B paragraph 2.2.4 and for the GT licence also Special Condition 2.6 Part B paragraph 2.6.4) which results in the ADJ adjustment being adjusted for in each subsequent year, with the direction of adjustment being the reverse of the prior year. This impacts every year from the Regulatory Year in which the initial ADJ adjustment onwards.</p> <p>The ongoing annual adjustment occurs as a result of the algebra used to calculate ADJR. The current Calculated Revenue for a given Regulatory Year is compared to the Calculated Revenue for the Regulatory Year as per the previous Annual Iteration Process plus the ADJ adjustment used to describe the revenue catch up for previous years. The inclusion of the ADJ adjustment in the comparison is incorrect and results in the perpetual cycle of annual ADJ adjustments.</p> <p>There is no net impact on the Allowed Revenue term as, for all years post the Regulatory Year in which the initial ADJ adjustment is applied, the K term is calculated to include an adjustment equal in magnitude but opposite in sign to the ADJ term (SpC 2.3 Part A paragraph 2.3.3 in the ET licence and SpC 2.3 Part A paragraph 2.3.4 and SpC 2.7 Part A paragraph 2.7.4 in the GT licence). The cumulative impact of 5 years of adjustment to prior year performance is also likely to result in ADJ and K terms of increasing magnitude across the price control period.</p> <p>Whilst the overall magnitude of Allowed Revenue may be correct, the values reported under ADJ and K will not correctly reflect the performance and level of revenue recovery delivered by the licensee. This is misleading from a reporting perspective.</p> <p>We note however, that the PCFM does not align with the licence algebra and correctly compare Calculated Revenue values from the current and previous versions of the PCFM.</p>
--	---

	<ul style="list-style-type: none"> The PCFM calculates (Allowed Revenue) ARt for each Regulatory Year at each iteration. The ARt value comprises (as per the licence drafting) Calculated Revenue, ADJt and Kt components. For a given iteration the ARt value for the forthcoming and forecast Regulatory Years will therefore be updated to reflect changes in these components. These changes are not automatically reflected in the Recovered Revenue input resulting in an over/under collection assumption for the forthcoming and forecast Regulatory Years. This generates a K value which in turn then affects subsequent years ARt values, reducing the relevance of the forecast values. Given that charges have not been set for future Regulatory Years, no over or under recovery should be forecasts at this point. To overcome this issue and set future K values to zero, the user has to manually update the Recovered Revenue so that it reflects the newly calculated Allowed Revenue (inclusive of ADJ and K) in order to prevent the generation of a K value rolling through into all future years. This makes the process unnecessarily complicated. We therefore propose that the setting of Recovered Revenue equal to ARt for the forthcoming and future Regulatory Years is added to the PCFM macro to improve process efficiency. The following comment is specifically and only in relation to the ET2 PCFM. The ARt tab includes a recovery penalty calculation which is triggered when recovered revenue falls outside of a 6% threshold of Allowed Revenue. The triggered penalty flows into the Allowed Revenue calculation, which is inconsistent with the proposed licence drafting. This section of the AR tab should be removed entirely to ensure consistency with the licence drafting. In addition, any revenue to the recovery penalty, such as the presentation of the annual values within the Live Results tab, should be removed to align with the licence. <p>NGET Tab for ET2 PCFM / NGGT TO and NGGT SO tabs for GT2 PCFM</p> <ul style="list-style-type: none"> We expect the RIIO-T2 Opening RAV to be updated for the remainder of RIIO-T1 reporting when the regulatory reporting submissions are made. The current RAV is aligned with the December 2019 LiMO submission which was based on the July 2019 Regulatory Reporting Pack submission. <p>Outperformance</p> <ul style="list-style-type: none"> The Outperformance tab calculates an incentive values for the outperformance wedge based on a basis point value which is input as standing data on the NGET tab in the ET2 PCFM and the NGGT TO tab in the GT2 PCFM. The ODI revenue component of Calculated Revenue is the sum of this outperformance revenue plus the actual incentive performance value. The Outperformance tab is redundant as actual incentive values are included and should therefore be removed. <p>Revenue</p>
--	--

	<ul style="list-style-type: none">• There is a Return adjustment (RTNAt) input within the Calculated Revenue calculation which is defined as a Fixed input value according to the Model key. There is no further information on the definition or determination of this value in either the licence or the PCFH. We require further clarity on RNTAt before we can provide comment on this input.
SUPPORTING INFORMATION	
OFGEM ENGAGEMENT:	