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4th June 2021

Wales & West Utilities response to Ofgem's Consultation on Network Output Measures (NOMs) Incentive Methodology

Dear Thomas

Please find below, our response to the consultation. Please don't hesitate to make contact for any areas of clarification.

Kind Regards

Ian

Ian Dunstan
Asset Strategy Manager
07785725267

General feedback

- 1. Do you have any comments about the overall process of this consultation?***
- 2. Do you have any comments about its tone and content?***
- 3. Was it easy to read and understand? Or could it have been better written?***
- 4. Were its conclusions balanced?***
- 5. Did it make reasoned recommendations for improvement?***
- 6. Any further comments***

We understand that some of the proposed changes are required to support the final assessment process, however the consultation goes beyond this by altering established methodologies which the networks have relied on in planning their investment strategies.

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For incentives to work effectively, they rely on ex ante, stable, unambiguous targets, and parameters for the networks to deliver the intended outcomes for customers over the term of the price control which is demonstrably not the case with NOMs. The latest consultation exemplifies this through further changes proposed after the price control period has ended which could affect expected outturn performance for some networks.

Examples such as new data requirements would be reasonable recommendations to improve NOMs at the start of a Price Control but are un-reasonable to impose after an eight-year Price Control has finished. The data will not have been collected in this form through the control and the level of assumptions and re-work required post Control is significant and likely to result in error.

On a positive note, the document is well written, easy to follow and asks relevant questions. The issue is much more around timing and the level of change proposed post Price Control.

Specific questions

Question 1: Do respondents agree with our proposed approaches to address the areas for review in the methodology? If not, please specify the area(s) where you have an alternative view and the alternative approach you suggest is adopted in order to update the methodology.

Application of Relevant Risk Changes (following rebasing)

We have no issue with five of the seven relevant risk changes proposed but do have comments on the treatment of two of them - deterioration and load related changes: Deterioration –

- Gas assets are generally long life and not allowed to deteriorate to end of life in many cases due to the associated high consequence of failure. As such, there is little data to validate deterioration rates towards the end of the assets lives.
- There are many hundreds of thousands of assets with many difficult to inspect. As such, condition is often inferred by faults and failures which can be driven by winter severity.
- Gas assets are generally repairable and do not fail beyond repair often. This can make it difficult to validate deterioration forecasts compared to assets that usually fail every 10 years and data shows it's now every 8 years.

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- For these reasons, deterioration curves on gas assets are derived using best practise statistical techniques. These are regularly reviewed, but it is not sensible to update forecasts of deterioration every year

Load related changes

- These are not used to forecast risk and set targets in a price control
- The Ofgem proposal would require us to add them in just to take them back out of the assessment
- It makes much more sense to leave these out of NOMs through the price control and to rebase the asset populations at start of the next price control

In terms of the ordering of non-intervention risk changes, we offer no alternative view to Ofgem's proposed approach.

One thing we would raise is the requirement to justify zero values in non-intervention risk changes. The Networks and Ofgem agreed and approved the NOM's methodologies late in GD1. Networks had to focus on embedding these into their businesses. As a result, there were very few changes and updates applied to the NOMs models between adoption and GD1 close. Ofgem are requesting justification for zero values, but as there's no requirement to have made updates between rebasing and March 2021, we would request a pragmatic approach to zero values with a general justification as explained above.

Approach to deriving associated costs

We do not think it is appropriate for GDNs to determine the allowances that Ofgem set for GD1. We do not have the data, analysis, and the knowledge of how this was done by Ofgem and would require significant assumptions. This would introduce discrepancies between networks and remove any comparability. We strongly believe that the allowances should be provided by Ofgem and the costs of delivery, by the Networks. Any other approach would bring a conflict to the process for setting Price Controls. We would however welcome the opportunity to review and feedback on the allowances provided by Ofgem.

In terms of cost of delivery, the data requirements set out are very granular and cost data is unlikely to have been collected across the networks in this way through GD1. Consideration should be given to aggregation to simplify and improve the accuracy of the cost assessment process.

The materiality threshold (deadband)

The process for setting the dead-band is unclear and we believe, should be transparent. The document references the need for more data to calculate a dead-band, but it does not say what this data is in any detail or the proposed analysis process to determine the size of the dead-band. In addition, the timing of this is too late in the process and should have been set when the networks had time to react and

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respond. We believe that Ofgem should take a pragmatic view and apply the 5% as used for GD2.

Interactions with other mechanisms

Ofgem state *'a key consideration of the assessment process is to ensure that licensees are not doubly rewarded or penalised as a result of an interaction with another incentive mechanism. To avoid this, we reserve the right to make 'correcting adjustments' such that the policy intent of the original mechanisms is maintained'*. In our view, the rules of RIIO-GD1 were set out at the start and it is not reasonable to start changing the rules at the end of the control.

Timeline

No significant comments.

Question 2: Are there are other areas of the methodology that require changes that have not been outlined in Section 3?

There is little clarity on the methodology and process for assessing whether over or under delivery is justified or not and we would like this to be much more transparent. Networks are required to provide evidence to support this decision, but this is difficult to do without understanding the assessment process Ofgem plan to use.

Question 3: Do you agree with the proposed modifications to the NOMs Incentive Methodology?

We are fine with the changes outside of the comments we've made in response to Qu2.

Question 4: Do you have any views on the accompanying RIIO-1 NOMs Closeout Data Template and associated guidance?

We welcome that the template has changed from previous versions, to be more in line with the data required through GD1 in RRP Table 7.3. However, it is still very complicated and late in the day to introduce the additional requirements and level of complexity. Data has not been collected at this disaggregated level during RIIO-1 and assumptions would have to be applied to populate large areas of the template. In particular, cost information is not collected at NOMs intervention level and the data that is captured would include interventions which are not included in NOMs reporting. Whilst we are happy to propose a methodology for the cost information that is submitted as part of any justification case, the assessment will need to consider the assumptions that have been applied to that data.

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Detailed comments below:

- **Worksheet 1.2**
 - States 1.1 not 1.2 within the worksheet
- **Worksheet 3.1.1**
 - Units on the left-hand side are incorrect as all have km where some are number of.
 - Most of the calculations will zero out so not sure what this will tell Ofgem for GD.
 - Total network risk – incorrect term? Should also be greyed out as it's a mixture of volume units for GD that shouldn't be aggregated.
- **Worksheet 3.2**
 - Says RIIO-2 when it should say RIIO-1
- **Worksheet 3.2.1**
 - Says RIIO-2 when it should say RIIO-1
 - Units on the left-hand side are incorrect as all have km where some are number of.
- **Worksheet 3.3.1**
 - Units incorrect it should be R£m
 - Definitions aren't in the latest guidance. More clarification is required on how to populate this worksheet.
- **Worksheet 4.1.1**
 - Populating by year is going to be incredibly difficult, especially within the suggested timeframes. Suggest this is a total for GD1 rather than an annual breakdown.
 - If annual breakdown is required for the funding adjustments, could Ofgem use a weighted average for the cost of finance for the period or similar?
- **Worksheet 4.1.2**
 - Error on units for pre-heating
 - Same challenge on the by year break-down. Would suggest a total for GD1 period as suggested for 4.1.1.
- **Worksheet 4.2**
 - Not clear what data requirement is here. Is it risk or cost? Units imply that it's risk, but this needs to be explicitly stated in the guidance and worksheet.
- **Worksheet 4.3**
 - Column C – should this link to 4.2 or is this something else? Expectation needs to be explicit in the guidance.
 - Cell B24 should be R£m

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Question 5: Do you have any views on the timelines set out in the NOMs Incentive Methodology, including the nature of the data to be submitted by licensees at relevant assessment stages?

In our view, it is unfair to set a dead-band after the price control has finished. Price controls are based around rules and commitments, so all parties understand the expectations on them. There is no clarity on how a dead-band will be set and the data that will be used. A huge amount of data has been submitted to Ofgem since NOM's creation and we do not understand why assessment of dead-band couldn't have been completed on what has been submitted. A pragmatic approach was used for GD2 and we suggest this should be applied to GD1.

The Networks will not find out Ofgem's decision on over or under delivery until 30th November 2021. According to the timeline, we then need to provide justification a day later 1st December. It will not be possible to turn this around over one day. We would suggest 6 weeks should be given to provide the justification following Ofgem's decision.

Miscellaneous comments

One final observation is on the table relating to sectorial differences on page 11. The 'Output Category' for gas distribution is a Secondary Output Measure. The 'NOMS outputs' for GD do not include asset condition, network outputs or replacement outputs. The outputs as agreed are network risk, number of failures and a health and risk categorisation.

We look forward to working with Ofgem to further refine the GD1 close out framework and rules and to see the close out process through to completion.

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