

4<sup>th</sup> June 2021

Thomas McLaren  
Network Price Controls  
Ofgem  
10 South Colonnade  
Canary Wharf  
London  
E14 4PU

Dear Thomas:

**Northern Gas Networks response to Ofgem Consultation: RIIO-1 NOMs Incentive Mechanism Consultation**

Thank you for the opportunity to respond to this consultation. Northern Gas Networks (NGN) has been actively involved in the NOMs cross-sector working group and welcomes the opportunity to provide feedback on the proposed changes to the incentive mechanism and the RIIO-1 Performance Report data submissions.

We are in broad agreement with the approach outlined in the RIIO-1 NOMs Incentive Methodology consultation and consider that the main principles within the assessment mechanism are appropriate. However, we have concerns regarding the timelines set out in the methodology as we do not believe that they give Licensees sufficient time to ensure that all data submissions are high quality and robust. As this is a close-out process, there should be sufficient time built into the timelines to enable companies to collect, analyse and quality assure data appropriately, however we do not believe that this is possible to achieve within the proposed timelines. We recommend that companies are provided with at least two months from a data request being made until the deadlines for submission to enable companies to be confident in the quality of data being submitted.

Additionally, we are concerned that the data requirements for the NOMs RIIO-GD1 (GD1) performance close-out are being set out after the completion of RIIO-GD1. Whilst we welcome that the template is more in line with the data submitted as part of Table 7.3 RRP, there are still many tables and worksheets within this template which request data at a level of granularity that is beyond what has been collected for RIIO-GD1. In addition, allowance information has not been supplied at this level of granularity by Ofgem and it does not feel appropriate for companies to be applying assumptions to the data after the regulatory period has ended. It is important that company submissions require the data to be reported at an appropriate level where there is sufficient confidence in that data; disaggregating data beyond these limits poses a risk to undermining the quality of the data submissions, as well as requiring significant resource to apply assumptions to the raw data to manipulate it to meet the submission requirements.

Our response to the questions that you have raised in your consultation are provided in Appendix 1.

We look forward to working with Ofgem in finalising and delivering against this approach. Should you wish to discuss our response to this consultation in more detail, please do not hesitate to contact

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Claire Spencer, Risk and Investment Manager by email [cspencer@northerngas.co.uk](mailto:cspencer@northerngas.co.uk) or phone 07580 994344.

Kind Regards



Gareth Mills | Regulation & Strategic Planning Director  
Northern Gas Networks

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## Appendix 1 – Northern Gas Networks Consultation Response

### **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?*

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.

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.

**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.*

In general, we agree with Ofgem's proposed approach to address areas for review in the methodology in that we understand that some of the proposed changes are required to support the final assessment process, however we have concerns with the timing and transparency of the assessment process that is within the methodology. The data requirements are now being changed when RIIO-2 has commenced and are therefore being made after the fact. These changes could have led us to have made different decisions if this rule-set had been determined during RIIO-1. It is important that lessons are learned from this so that companies have a full understanding of the reporting requirements and implications of investment trade-offs when it comes to NOMS (and now NARMS) as early as possible, to enable monitoring within the RIIO periods as unpicking this information after the price control is a less robust and transparent approach.

We agree with the proposed approach to set deadband at a network level as this promotes risk trading and is in line with how the target has been set for Gas Distribution (GD), we also agree with the principle of the deadband being set around the delta. In our view the size of the deadband should be set pre-normalisation. i.e. if 5% = +/-1£Rm, the post normalisation dead band should still be +/- 1£Rm not 5% of post-normalised results.

We agree with Ofgem's proposals that load related additions should be included within the NOMS risk position, as this provides a full picture of asset risk and the RIGs for RRP Table 7.3 state that additions should be included within annual risk reporting submissions. As NGN have followed the

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recommendation from the RIGs, additions and removals have been captured within our NOMS metric reporting throughout RIIO-GD1. However, as the RIGs have not required the separation of this data, it has been inbuilt into the NOMS reporting and it is very difficult to differentiate in terms of reporting a disaggregate view of the risk associated with these assts at this stage of the process. If the requirement to disaggregate this data had been set out as part of the RIGs for RIIO-GD1, it would have been possible to collect and retain this data, enabling this level of reporting.

We do not think that it is appropriate for Licensees to be determining the NOMs allowances. GD have not been provided with the level of detail required to state a view of what the NOMs allowances should have been for RIIO-GD1 and additionally this causes a conflict in responsibility. As Ofgem set the allowances for RIIO-GD1, it should be Ofgem who disaggregate these to provide a NOMs allowance. We are happy to review any data that Ofgem provide on the NOMs allowance, but ultimately it should be down to Ofgem to set the allowances. Additionally, whilst we can provide a proposed methodology for the determination of incurred costs, cost information has not been collected throughout RIIO-GD1 at the level of detail that Ofgem are now requesting as part of the close-out process. Especially early in RIIO-GD1 much of our cost information has been aggregated to a site or even multiple site level. To drill this down to a NOMs asset class will require assumptions to be applied to the data to meet this data request, which could undermine the robustness of the assessment process.

NGN have no major issue with the ordering of non-intervention risk changes and therefore agree with the ordering that Ofgem have put forward. However, as non-intervention risk changes are a new concept, the ordering may need to be reviewed as part of the RIIO-2 close-out process.

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

We are concerned that Ofgem's assessment approach lacks transparency. It is not clear in the methodology what Ofgem's criteria is for assessing non-intervention risk changes, justification cases and setting the deadband level. Ofgem need to be clearer on how this assessment will be made and what the impact of the assessment will be, for example the following questions remain: will non-intervention risk changes be accepted/rejected wholly? Or will it be possible to partially reject them? If so, what is the criteria for assessing the proportion that is accepted? We are additionally concerned that the size of the deadband will not be determined until after companies' submissions in July 2021, which means that consequently the target and tolerance around this has not been determined within the period whereby companies are delivering against the target. The targets and tolerances around them should be agreed at the start of the RIIO period to ensure that companies can use this information in evaluating investment decisions.

In the methodology it states that at Stage 4 Ofgem may require Licensees to provide supplementary data in an agreed template format. Can Ofgem outline if this is an additional template over and above what has been released within the close-out Excel Spreadsheet template. If it is an additional

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template, what are the timescales for this template being released to companies and will Licensees be involved in the development of this template?

NGN disagree with the NOMs outputs that are listed for Gas Distribution in the table in section 2.5 of the consultation document. The NOMS outputs for GD does not include asset condition, network outputs or replacement outputs, the outputs are network risk, number of failures and a health and risk categorisation.

The guidance for completion of the Stage 1 and 2 narrative implies that relevant risk changes can be a 'free text'. Whilst we welcome the inclusion of a 'free text' categorisation for the non-intervention risk changes as this provides a level of flexibility that we believe is required, it is an omission from the methodology especially with respect to how this would impact the ordering of the non-intervention risk changes.

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

As detailed earlier in our response, our main concern with the proposed modifications is the timing; changes to the methodology should not be proposed after the RIIO-1 period as companies cannot retrospectively undo decisions that will impact an as yet undecided performance assessment.

We also have concerns with the level of detail of the data submissions that is set out within the methodology, these concerns are mainly related to the timing as this data was not part of the reporting requirements for RIIO-1 annual reporting and have therefore not been historically collected. For example, non-intervention risk changes includes a separate category for asset additions; NGN have captured additions within the annual Table 7.3 reporting therefore it is not possible to provide this level of disaggregation in a robust manner and will require assumptions to be applied to meet this data requirement. NGN have undertaken a very simple analysis of the assets that would be impacted by any additions and estimate that the impact on Monetised Risk is insignificant. Additionally, as the Monetised Risk target for GD is a delta value, we do not think that this level of disaggregation is beneficial to the non-intervention risk changes assessment as these should not impact the delta position due to it being determined based on the pre-existing asset base.

In our view, we believe that it is too late to include pre-RIIO changes as this would require obtaining detailed data sets from over 8 years ago. However, as GD have rebased targets from 2018 we do not believe that this would be applicable to GD.

The Incentive Methodology states that Stage 6 should be an assessment that under/over delivery was in the interest of consumers. We would suggest that this is amended to be in the interest of stakeholders not just consumers. An investment decision could be in the interest of a stakeholder rather than a consumer and it could still be the correct asset management decision, e.g. an asset might have been replaced because it posed an unacceptable health and safety risk to employees and such investment might not drive a direct consumer benefit.

The proposed methodology states 'The associated cost of over-delivery will be based on Ofgem's view of efficient costs for the over-delivery element', this contradicts the Final Proposals for GDN's and we

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consider that it should be specifically stated that performance against targets will not be subject to an efficiency assessment.

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

Whilst NGN welcome that the template has moved to be more in line with the structure and information held within RRP Table 7.3, we believe that it is still too complicated and too late in the day to introduce this level of complexity. Whilst in principle we agree with categorisations within the template, the 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 which could undermine the quality of the data submissions. For example, 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.

Additionally, whilst we appreciate that much of the data requested in the associated narrative for the July submission is a recommendation, NGN do not consider that a lot of the requirements outlined in the guidance is appropriate for inclusion in the Stage 1 and 2 submission narrative. For example, a detailed list of interventions, as this information is already contained within the NOMs methodology.

We are also unclear on what Ofgem's expectations are regarding the rationale for zero values for non-intervention risk changes. Ofgem set out in the guidance that where non-intervention risk changes are not applicable, a value of 0 should be entered, however this must be accompanied with a rationale. We expect that in most cases the rationale would be that they are not applicable or were not undertaken and any rationale that goes beyond this feels inappropriate and disproportionate. In our view, rationale should only be provided where companies have proposed a non-intervention risk change.

It is also worth highlighting to Ofgem that due to NGN using a statistical approach to determine the NOMs targets for RIIO-GD1, the only data available to populate 3.1\_Targets\_GD and 3.2\_Delivery\_GD is the number of assets (column K) and monetised risk (column Q). This position has been reflected in NGNs previous RRP Table 7.3 submissions. The guidance states that this information must be completed, but this will be impossible for NGN to complete and we suggest that NGN leave these fields blank in the close-out template submissions.

As outlined in our response to Questions 1 and 3, NGN are not able to segregate with a large degree of confidence the impact due to load, especially at the level of detail set out in the template. The RIGS state that Licensees should include additions in their RRP Table 7.3 submissions, so NGN have always included this data and it is not possible to retrospectively split out this information accurately. Many assumptions would have to be made to obtain this level of disaggregation and if the target is set at a network level, it is unclear what value this would add to the assessment. Additionally, we could not produce this disaggregated information for the 31<sup>st</sup> July timeframe. As stated earlier in our response NGN have undertaken a very simple analysis of the assets that would be impacted by any additions

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and estimate that the impact on Monetised Risk is insignificant. This simple analysis has been sent to Ofgem ahead of this response.

We agree in principle with the non-intervention risk change categories, however data to support this submission has not been collected throughout the period and it may not be possible to supply this information robustly for RIIO-GD1 at this disaggregated level. It may be that in the submission of non-intervention risk changes that these can only be supplied as one high level non-intervention risk change, or assumptions will need to be applied to segregate the data in this manner. We are also supportive of the inclusion of a free text normalisation as this process has just been introduced, therefore a degree of flexibility in companies' data submissions is required. As the process becomes more mature in RIIO-GD2 and the data requirements are more explicit, the categories may need to evolve as understanding and application of the NARMs methodology matures.

Our feedback on the template worksheet, by worksheet is listed below:

- 1.2\_Performance\_Relative\_Target
  - States 1.1 not 1.2 within the worksheet
  - Targets should be adjusted pre-normalisation.
- 3.1.1\_Targets\_Volumes\_GD
  - Units on the left-hand side are incorrect: all units are listed as Km' however some asset categories should be 'Number of'.
  - Most of the calculations will zero out for GD due to assets mainly remaining in the same asset category, therefore we are unsure what value this worksheet will provide to Ofgem for GD.
  - What is the 'Total Network Risk' on this worksheet trying to represent? Is this correct term. Additionally, this should be greyed out for GD as volumes are a mixture of different unit types and should not be aggregated.
- 3.2\_Delivery\_GD
  - States that it is the 'asset base at end of RIIO-2' when it should say RIIO-1.
- 3.2.1\_Delivery\_Volumes\_GD
  - States that it is the 'asset base at end of RIIO-2' when it should say RIIO-1.
  - This worksheet will effectively be zero for GD as we do not provide volumes except for mains and LTS diversions and converting LTS to piggyback.
  - Units on the left-hand side are incorrect: all units are listed as Km' however some asset categories should be 'Number of'.
- 3.3.1\_Normalisation\_Targets
  - The guidance does not state what year the data to populate worksheet 3.3.1 would be, we suggest that it is using 2021 data.

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- The units are incorrect as it should be 'R£m'.
- Definitions are not contained within the latest guidance. More clarification is required on how to populate this worksheet.
- 4.1.1\_Expenditure\_Allowed
  - We do not have NARMS allowance information for RIIO-GD1 and have never been provided this by Ofgem. As Ofgem set the allowances, in our view Ofgem should be populating this worksheet as it would be inappropriate for GD to do so. We are happy to quality assure any values that Ofgem populate should this be required.
  - The worksheet asks for links but these are then summed in column C. More clarity is required on whether this should be a link or an equation?
- 4.1.2\_Expenditure\_Outturn
  - As highlighted earlier in our response, NGN do not collect expenditure information at NOMs asset category and intervention level, therefore although we can propose a methodology to populate this worksheet, assumptions will be required to support the derivation of this information. Additionally, how will Ofgem decide on a methodology? Will this be specific to companies, or will this be applied across the sector? If the methodology is applied across the sector then this may create some challenges in populating this data as cost data will be collected differently by each company.
  - The worksheet asks for links but these are then summed in column C. More clarity is required on whether this should be a link or an equation?
  - There is an error regarding the stated units for pre-heating
- 4.2\_OD\_and\_UD\_Factors
  - It is not clear from the guidance what data needs to be submitted in this worksheet. Is it monetised risk or cost information that needs to be submitted? The units imply that it is monetised risk information, but this needs to be explicitly stated in the guidance and worksheet.
- 4.3\_OD\_and\_UD\_Associated\_Costs
  - The guidance for associated costs needs to be clearer, we are unclear what the data requirement is for this worksheet.
  - 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?***

It is not clear from the NOMs Incentive Methodology and following discussions with Ofgem what the timelines are for the data submissions and when Ofgem will inform companies that they need to complete a Stage 5 submission. We suggest that the dates are captured in a table as well as in diagram/process format to make it explicit when information will be released by Ofgem and when Licensees are expected to submit data. Additionally, it appears that there are mistakes in the proposed timelines as it appears that Stage 4 completes the day before companies are required to submit Stage 5 submissions. This error has been raised in previous cross-sector meetings with Ofgem, but this has not been updated in the diagram. We would suggest that the timeline also includes the date for the deadband decision as this is currently embedded within the text of the documents and it would be beneficial if all dates in the assessment process were explicitly stated collectively.

We generally agree with Ofgem's proposals for the data requirements for the 31<sup>st</sup> July submission, however we do not believe additions should be disaggregated for this submission, due to the reasons listed earlier in our response. Additionally, we must receive the template by end of June at the latest to be able to audit and quality assure any data submissions to meet the end of July deadline, however we would welcome an earlier release of the template if possible, to allow companies' as much time as possible to work on the data submission.

There seems to be a disjoint between the deadline for Stage 4 completion and Stage 5. If Stage 4 is the assessment against the target, then in our view this information is required for companies to submit data against Stage 5. Paragraph 3.6 of the methodology states 'If the Licensee's is judged by Ofgem to sit outside a materiality threshold then it must provide a further submission by 01 December 2021', but it is unclear from the methodology when companies will be informed that they must provide a justification case i.e. have to complete Stage 5. If companies are informed of this at the completion of Stage 4 (30<sup>th</sup> November 2021), this effectively gives Licensees one day from being notified, to having to submit their Stage 5 justification case. This is an impossible timescale to meet, especially since Ofgem expects Licensees to justify the delivered level of NOMS compared to the NOMs targets, therefore Licensees require information relating to Stage 4 before they can appropriately complete Stage 5. In our view, Licensees would require at least two months from receiving the results of the Stage 4 assessment to submitting their Stage 5 justification case to allow adequate data collation, justification and quality assurance that would be expected as part of a close-out process.

Generally, the proposed timelines do not provide Licensees with sufficient time to produce high quality submissions that would meet Ofgem's requirements as set out in the methodology document. The timelines feel very one-sided as Ofgem generally seem to have three or four months to assess the submissions, whereas at most, Licensees are provided with a one month turn-around period. We ask that Ofgem review the time that has been allowed for companies to complete their submissions, in particular Stage 5 and review whether they could be adjusted to be more proportional; we would suggest that Ofgem and Licensees are provided with at least two months to complete the relevant

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stages. We believe that this could be possible and still not delay the final decision deadline. It is worth highlighting, that in order to submit a high quality Stage 5 justification case, Licensees would require all of the following information: deadband decision and resulting tolerance value around the target, Stage 3 completion and assessment shared with Licensees and Stage 4 completion and assessment shared with Licensees. Even with allowing for a two month turn-around period for Licensees, it is expected that companies will still commence the collation of material for any justification cases after Stage 1 and 2 completion as there is a lot of detail required for the justification cases, which will be difficult to turn-around with even the extended time frames. Therefore it is expected that companies that may not go into a Stage 5 assessment, will still focus effort on co-ordinating and obtaining data for a Stage 5 submission, because timescales are very challenging.

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