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Dear Thomas,

Network Output Measures (NOMs) Incentive Methodology

Scottish Hydro Electric Transmission (SSEN Transmission) welcome Ofgem's consultation on the proposed changes to the Network Output Measures (NOMs) Incentive Methodology. As the RIIO-T1 price control period is now finished and we are into the first year of the RIIO-T2 it is essential that there is clarity on the RIIO-T1 Close Out process as soon as possible, which includes the Close Out of NOMs. We welcome Ofgem's recognition of several outstanding issues with the 2018 NOMs Incentive Methodology, but remain disappointed that it has taken three years, and until the RIIO-T1 price control period is finished, for Ofgem to begin to address these issues.

There are two general, but key, points we would make before responding the points in the consultation.

First, it is fundamental that Ofgem assess the Close Out of NOMs **based on the RIIO-T1 framework** and should not use parts of the RIIO-2 NARM framework to close out the RIIO-T1 NOMs output. They are different mechanisms with different requirements placed on network companies and we are concerned that they are being treated as one in the same. For example, Ofgem has referred to the level of information to be provided to justify network company's delivery in the form of the RIIO-2 Engineering Justification Packs, however, this was not a requirement of RIIO-1 and this level of detailed information was therefore not provided for those schemes which make up the RIIO-1 targets. Therefore, it is unreasonable to request network companies to justify its delivery to this level of detail when this information may not have been captured or recorded during the RIIO-1 period given there was clearly no requirement to do so.

Second, SSEN Transmission has undertaken the right non-load investments at the right time, and it is up to us to demonstrate that these interventions were made in the consumer's interest through the NOMs Close Out process. If we do so, then we expect to be able to recover the costs associated with our over-delivery and receive a reward. Ofgem is consulting on the NOMs Close Out Methodology when the price control has ended and ultimately the network companies are powerless to make any changes to their interventions, retrospective or after the event decisions poor is regulatory practice.

The scope of the RIIO-1 NOMs close out has changed exponentially from our understanding in the Working Groups and providing the level of information which Ofgem is requesting is not a simple task for the Network Companies. This is clearly acknowledged by Ofgem, to an extent, through the informal extension (via email) of the 31st July deadline which is prescribed in our licence, to the 14th September to allow Network Companies to provide the total asset base data (i.e. the inclusion of Load related interventions). As outlined below, we do not see the benefit in some of the retrospective changes which Ofgem is looking to introduce, such as the inclusion of Load Related interventions.

In addition, we are concerned with the timings of this consultation in relation to the Close Out process; consultation responses are due on 4 June 2021 which is only 8 weeks from the date Transmission Owners are required to submit their first Close Out reports setting out their RIIO-1 Network Output or any Materially Equivalent Outputs. It is unfair on Network Companies for Ofgem to be changing the scope of the NOMs closeout process and finalising new Data Tables which have never been populated before in such short timescales. This provides insufficient time for Ofgem to assess the consultation responses and reach a decision in which TOs can reasonably be expected to respond to any further changes, bearing in mind the Data Assurance requirements on the Network Companies, that will mean that the Close Out reports will have to be prepared c.4-5 weeks after the consultation.

On the outstanding elements of the NOMs Incentive Methodology which this consultation is aiming to address, we have provided key feedback on the areas being addressed by Ofgem in the covering letter below. We have also provided our responses to the 5 questions posed in the consultation document in the Appendix below.

1. Rebasing licence targets

We understand the need to rebase the RIIO-T1 targets from volumes into monetised risk to allow Ofgem to fully assess the Network Companies delivery of their Network Replacement Outputs, considering of any trade-offs between asset categories, which would not have been possible against the original volumes-based targets. We note that this exercise is now complete, however, as we outlined at the time we were disappointed that such a rebasing exercise was being undertaken in the latter years of the price control and did not conclude until

December 2020, almost 7 full years into an 8 year price control. At this point, all RIIO-T1 asset interventions or decisions regarding future interventions had been made, based on the original NOMs methodology and volumes-based targets. Therefore, we highlighted that it is essential that Ofgem gives due consideration to interventions made under the original NOMs methodology when assessing the close out of the NOMs. This remains our position.

2. Use of a materiality threshold (deadband) around target performance

It has been long understood that upper and lower materiality thresholds (a “deadband”) would be used when assessing Network Companies compliance with the overall network target and that this would be applied at the network level to facilitate monetised risk trading across asset categories. Understanding what this deadband will be is essential for network companies to be able to state whether it has delivered its RIIO-1 Network Outputs (as specified in table 1 of Special Licence Condition 2M of the RIIO-T1 licence); or a “Materially Equivalent Output”; or a “justified material over-delivery”; or a “justified material under-delivery” as specified in paragraph 2M.3 of SpC 2M of the RIIO-T1 licence and SpC 7.10.3 of the RIIO-T2 licence.

The RIIO-T1 deadband should have been formulated and signed off during the T1 period and well ahead of the RIIO-T1 Close Out process. We believe it is unacceptable for the deadband to be set retrospectively after network companies have submitted their final NOMs outturn position and have no opportunity to revise their plans and interventions. Therefore, we remain extremely disappointed to note that Ofgem has not set the deadband values and is proposing to determine the deadband value following the submission of the Performance Assessment Report on the 31 July 2021. It is essential that Ofgem notify network companies of the materiality threshold by **no later than 16 September** and we would recommend that this decision date is embedded into the flow diagram on page 9 of the NOMs Incentive Methodology. The longer Ofgem take to assess the Networks Companies delivery against their targets increases the risks of Network Companies wasting resources, time and money in gathering evidence and justification to explain any possible under or over delivery. Resources which should be being used on T2 Asset Management activities.

In addition, we note that Ofgem specified that the reason for not setting this deadband is due to receiving insufficient data from licensees to allow Ofgem to assess how well it supports their outputs and in the absence of sufficient data Ofgem are not able to set the deadband values. We are confused by this statement as, until this point, Ofgem has never requested additional data from network companies, nor indicated that it had not received sufficient data to facilitate the setting of the deadband. We would welcome clarity from Ofgem as to what data it requires in order to be able to set the deadband values (on top of the annual performance data it receives through the annual RRP process and the data it received to assess the rebasing of the NRO).

As a minimum, we would expect Ofgem to set out the methodology which it is proposing to use in order to set the deadband values.

3. Calculation of costs associated with over-delivery or under-delivery

We welcome Ofgem's acknowledgement for a project-by-project approach for the calculation of costs associated with over-delivery or under-delivery in Electricity Transmission.

In order to calculate the costs associated with any over or under-delivery, we believe the subsequent steps should be followed which are relatively straightforward:

- **Identify overall delivery (inc. any over or under delivery):** Identify what over or under-delivery against targets exists for the network companies, if any at all, via an assessment of the asset intervention data and relevant risk changes (noting this requires clarity regarding the deadband).
- **Identify specific project substitutions and additions:** Account for any substitutions made within and across asset categories. This stage will identify what projects were substituted in and out in order to meet the NOMs target and, any additional asset interventions undertaken by the Network Company.
- **Identify the interventions which contribute to the over/under delivery:** Then any additional, or shortfall in, asset interventions should relate to the network company's over or under-delivery.
- **Allocate costs to the over/under delivery on a project-by-project basis:** There should be clear examples of projects, or parts of projects, which would contribute to the over or under delivery and therefore have clear project costs which can be apportioned to the over or under delivery.

In SSEN Transmission's case, we are anticipating an over-delivery against our target, but it is difficult to comment on the extent of any over-delivery in the absence of any deadband values being set by Ofgem. This will be demonstrated and explained in detail as part of our performance assessment submission on the 31 July, but we note at this stage our over delivery can be explained by both undertaking more projects and increasing the scope of projects. For instance, we have undertaken asset interventions in asset categories where we did not have any planned interventions in our original RIIO-T1 Business plan, such as reactors, fittings and towers. We also have examples of individual projects which relate to this over-delivery and believe it will be the costs associated with these projects and asset interventions which should be included in the second price control period allowances, regardless of whether it is justified or not (as per Table 2 in SpC 2M of the RIIO-T1 licence and Appendix 1 of SpC 7.10 of the RIIO-T2 licence).

However, we would highlight that we have not tested this approach of calculating costs for over or under delivery before and we appreciate that there is other methodologies which can be used for determining these costs, such as the approach used for DPCR5.

4. Interaction with other licence mechanisms

Ofgem has stated that it believes there is an interaction between NOMs and the load related mechanisms and that this can be addressed through Relevant Risk Changes. It has therefore asked for the inclusion of load related additions within the NOMs Close Out submission and reserving the right to make any correcting adjustments if it determines there is such interactions.

We have fundamental concerns with this. First, Ofgem is redefining NOMs from a mechanism to identify performance for targets set for non-load lead asset only to something else? Second, we see no valid rationale for the data request. Third, and with the second point in mind, this is significant work for the TOs and we do not see the value.

It is important that Ofgem does not lose sight of the RIIO-1 intention of NOMs, which is an outputs mechanism focussed on **Non-Load Lead Assets only**. NOMs is the mechanism for monitoring and assessing the **network asset management** outcomes which network companies deliver, rather than monitoring and assessing the network as a whole. Load related works are funded via different mechanisms or allowances and therefore should not be considered as part of any Non-Load assessment. Network companies should only be required to provide NOMs data net of load related additions, which is consistent with the rebasing process that we undertook towards the end of the RIIO-T1 period.

While we acknowledge the development of NOMs to NARMs, and in discussions for the new RIIO-T2 NARMs framework there is a move to include load data, Ofgem must avoid conflating NOMs and NARMs. Therefore, we are surprised that Ofgem has requested that network companies NOMs outturn position for RIIO-T1 must include the load related additions and this was not our understanding of the RIIO-T1 mechanism or from the Ofgem working groups.

To our second point, we do not see the value in Ofgem having such information and its proposed reasoning makes little sense to us. Therefore, we are keen to understand Ofgem's rationale for and the value in receiving this information before putting extensive resource into such an exercise, i.e. what benefit Ofgem will gain from receiving the data for the network as a whole (i.e. including load related works)? As outlined previously, a lot of work is required to provide the monetised risk for load related additions along with the non-load related output. We therefore welcome clarity from Ofgem on what it aims to achieve from this data in order to justify the additional resource and effort required, as we are having to divert Asset

Management staff from important T2 work in order to provide this data on a full-time basis between now and the submission dates.

Ofgem state in paragraph 3.25 that it is proposing to apply adjustments from relevant risk changes to the monetised risk targets as this avoids changes to outturn delivery for RIIO-1 which will act as the starting point for RIIO-2. We fundamentally disagree with this.

The T1 out-turn full network position including load will not provide Ofgem with the RIIO-T2 starting position. The volumes of assets will be consistent, however, the monetised risk value will not. This is because the System Consequence for T1 Close-out is modelled on the network configuration at the start of T1 and is fixed so it does not lead to material change. The SSEN Transmission network has undergone a huge expansion during the T1 price control leading to a significant change to the system consequence of existing assets in addition to the new ones.

In order to get from the T1 Close Outturn position of NOMs to the start of the RIIO-T2 NARMS position a bridging exercise will be required to be undertaken. This cannot be achieved through the RIIO-T1 Close Out process due to the differences in System Consequence. We would recommend that Ofgem address this bridging exercise after the T1 Close Out process is complete, and by using the new RIIO-2 data tables which are very different to the data tables used in RIIO-1. If Ofgem do want to reconcile the start of RIIO-T2 to the end of RIIO-T1 then we would strongly recommend that this is done via a separate exercise following RIIO-T1 Close out using the RIIO-T2 data tables.

We would ask that Ofgem reconsider its position on its ask for extensive load data. If it is of value to the close out assessment, we will do our utmost to provide it, but we can't see the value and purpose of such an exercise for the reasons set out above.

5. Timeline for NOMs incentive process

The main challenge in the timeline for the NOMs incentive process is providing the NOMs outturn position if load related additions must be included. As outlined above, until the publication of this consultation, we understood that the data to be submitted on the 31 July was net of load related additions.

We had intended to submit our draft Close Out submission to Ofgem in May as requested, however, the request for additional information pertaining to our load related portfolio made this impossible to achieve. At the time of submitting this consultation response, we are 8 weeks away from the 31 July deadline. Taking into account the Data Assurance requirements which are needed prior to submission, this effectively brings the deadline date forward by c.4 weeks. Therefore, we are disappointed by how late in this process Ofgem is updating the methodologies, data templates and data template guidance.

If you have any questions regarding any of the information provided in this response, then please do not hesitate to get in touch.

Kind regards,

Sam Torrance

Transmission Regulation Manager

Appendix Consultation Question Responses

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.

We welcome Ofgem identifying the issues with the NOMs 2018 Incentive Methodology, these issues have been outstanding since 2018 and clarification on these issues is long overdue.

As outlined in the covering letter, we have a number of concerns regarding Ofgem's proposed approaches to address the areas for review in the methodology. To summarise:

- We are generally comfortable with Ofgem's proposals regarding the application of relevant risk changes.
- We are disappointed that Ofgem is not setting a materiality threshold (deadband) ahead of the required submission on the 31 July, we remain of the view that a 5% deadband seems reasonable and is consistent with deadbands used in this area in other price controls (DPCR5 and RIIO-2).
- We disagree with Ofgem's view that there is any interaction between NOMs and the Load related mechanisms. There are existing mechanisms to deal with any interactions with load/non-load related interventions. There is significantly more work required to provide a NOMs outturn position for RIIO-T1 which includes the load related additions and we cannot see the benefit which Ofgem is aiming to achieve by requesting this additional information.
- It was our understanding of the RIIO-T1 mechanism and RIIO-T1 licence (SpC 2M), that we would have to submit a Performance Report setting out our NOMs delivery against the targets set out in table 1 of SpC 2M. Therefore, we are reasonably comfortable with this initial deadline for the 31 July for stage 1 and 2, however this was prior to our knowledge that load additions will also be required to be included which is significantly more work with limited time in which to provide this. Therefore, the 31 July deadline for stage 1 and 2 is going to be extremely challenging to meet, especially when you consider that we only have 8 weeks from the time of responding to this consultation and additionally have Data Assurance requirements to undertake.
- We welcome Ofgem acknowledging the case for a project-by-project assessment for identifying the costs associated with any over or under delivery for Electricity Transmission. We would encourage Ofgem to implement this approach into the revised NOMs Incentive methodology.
- We disagree with Ofgem's statement in paragraph 3.72 that "The rewards and/or penalties are only one aspect. All under/over deliveries outside the deadband are required to be justified". As clearly outlined in Table 2: Treatment of under- and over-

delivery of Network Replacement Outputs of SpC 2M any cost of over-delivery shall be included in the second price control period allowances regardless of whether this is justified or unjustified. The only difference which justification makes is regarding the financing cost incurred by the licensee in advancing investment, or whether a reward or penalty may be applied.

As outlined in the covering letter, it is fundamental that Ofgem assess the Close Out of the RIIO-T1 NOMs based on the RIIO-T1 framework and should not be applying parts of the new RIIO-2 NARM framework when closing out the RIIO-T1 NOMs output.

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

We believe that Ofgem has identified the key issues of the 2018 NOMs Incentive Methodology which requires changes. However, as highlighted in the covering letter and our response to question 1, we do not believe that Ofgem's proposed approach provides the changes or clarifications which are required by Network Companies to close out the RIIO-T1 NOMs output.

One area which has materialised over the last 18 months and we would like to see clarified and reflected into the guidance documents is the treatment of RIIO-1 NOMs schemes which have been delayed by Covid-19. We acknowledge that Ofgem has responded to us separately on this matter via email, where it advised that Covid-19 delayed schemes would be treated as a "Relevant Risk Change" and that we would have to use one of the free text 'with intervention' adjustment columns on the Normalisations_Targets sheet to apply a normalisation. We would recommend that this approach is included within the RIIO-1 NOMs Incentive methodology and within the Data Template guidance.

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

No, as outlined in the covering letter and our response to Question 1 above, there are areas which we are comfortable that Ofgem has addressed, such as the relevant risk changes and the proposal to use a project-by-project assessment for identifying the costs associated with any over or under delivery. However, we disagree with Ofgem's proposed modifications for a materiality threshold (deadband) and that load related additions are required to close out the RIIO-T1 NOMs.

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

As outlined in our response to question 2 above, we would like to see the RIIO-1 NOMs Closeout Data Template and associated guidance updated to reflect the instruction we have received by Ofgem via email in the reporting of RIIO-1 NOMs schemes delayed by Covid-19.

Ofgem advised that Covid-19 delayed schemes would be treated as a “Relevant Risk Change” and that we would have to use one of the free text ‘with intervention’ adjustment columns on the Normalisations_Targets sheet to apply a normalisation. We would recommend that this approach is included within the RIIO-1 NOMs Incentive methodology and within the Data Template guidance.

We note that following the publication of the NOMs Incentive consultation on the 7 May 2021, Ofgem circulated revised RIIO-1 NOMs Closeout Data Template and associated guidance on the 17 May 2021 which attempted to provide further clarity on timescales. In our response to this on 19 May 2021, we highlighted an error with the revised data template where Ofgem has renamed the “Total Network Asset Base (i.e. including load related additions)” as the “Total Network Asset Base (i.e. asset base at the end RIIO-2)”. We believe this should actually read as “(i.e. asset base at the end of RIIO-1)”.

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?

We would like to highlight to Ofgem our concerns regarding the timings of this consultation in relation to the Close Out process, consultation responses are due on 4 June 2021 which is only 8 weeks away from when the Transmission Owners are required to submit their first Close Out reports setting out their RIIO-1 Network Output or any Materially Equivalent Outputs. This provides very little time for Ofgem to assess the consultation responses and reach a decision in which Network Companies can reasonably be expected to respond to any further changes, bearing in mind the Data Assurance requirements on the Network Companies.