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Sent by email to: Thomas.McLaren@Ofgem.gov.uk

Dear Thomas,

Network Output Measures (NOMs) Incentive Methodology

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group.

We continue to have significant concerns about the Incentive being implemented for the RIIO-1 electricity transmission (ET1), gas transmission (GT1) and gas distribution (GD1) price controls. It is not ideal that some key aspects of both how performance should be measured and how the Incentive should be implemented (such as the approach to deriving associated costs) remain unresolved.

Performance should also be assessed based on work volumes initially included in the companies' settlements:

We recommend Ofgem also assesses performance based on the work volumes initially included in the companies' settlements, as a 'sense check' of performance based on monetised risk.

The NOMs targets were converted from work volumes to monetised risk targets means in the last year of the ET1 and GT1 price controls and when there were less than two years remaining in the GD1 price control. Ofgem considers the rebased monetised risk targets are as 'equally challenging' as the work volumes initially included in the companies' settlements and considers assessing performance based on monetised risk to be appropriate.

We do not think that, without analysis, it can be safely assumed that both the above approaches would have resulted in similar or equivalent work volumes because they are different in some respects. For example, when the RIIO-1 price controls were set, it was not expected that companies could 'substitute' volumes delivered in an asset category in lieu of deviations from volumes initially agreed in other asset categories when assessing performance. However, the monetised risk approach allows such substitution by way of risk 'trading' across asset categories. This highlights that performance against targets should be assessed against those on which expenditure allowances were based. A parallel assessment based on work volumes would

provide stakeholders with comfort that assessing performance based on monetised risk could be in consumers' interests.

The NOMs incentive should be switched off for ET1, GT1 and GD1 price controls:

We continue to have significant concerns about the Incentive being implemented for the RII0-1 electricity transmission (ET1), gas transmission (GT1) and gas distribution (GD1) price controls. Risk targets were set in the last year of the ET1 and GT1 price controls when there were less than two years remaining in the GD1 price control. This means the companies could not have been 'appropriately incentivised'¹ to deliver the agreed targets because there was insufficient time to respond once the targets were agreed. Further, it is not appropriate that companies continue to be involved in the design of the mechanism given outturn performance has already crystallised. This creates a material risk of inappropriate gains.

We hope you find these comments helpful. Please contact Gregory Edwards (Gregory.edwards@centrica.com) if you have any questions.

Yours sincerely,

Kevin Woollard
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¹ As per the second principle of the NOMs incentive methodology
Page 2 of 2