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Dear Neill,

National Grid Gas Response to Ofgem's Network Output Measures (NOMs) Incentive Methodology Consultation

We welcome the opportunity to respond to Ofgem's Network Output Measures (NOMs) Incentive Methodology Consultation published on 7 May 2021.

We agree with the changes made to the NOMs Incentive Methodology document, such that the document now reflects the areas which still require Ofgem decisions. We welcome that the updated timeline has now been reflected in the document, detailing the requirements for each stage of the closeout process with associated dates of decision making. We also agree with the inclusion of the relevant risk category for "pre-RIO-1 work true-up" or "pre-RIO-1 work changes", where these have not already been addressed through rebasing". This is a normalisation step which will be applied to our data.

However, we remain concerned that key aspects of the Methodology, in particular the materiality threshold (deadband), are still ambiguous. It is unclear from the consultation what data Ofgem could use to derive an appropriate threshold. On these important elements where Ofgem still needs to make decisions, we would welcome further engagement, including clarity on the guiding principles for how Ofgem is planning to set the materiality threshold and what we can do to support this fundamental aspect of the performance assessment.

The consultation proposals on the calculation of associated costs for over- and under-delivery are also a concern. The approach is potentially altering the principles of the Methodology set at the beginning of the price control by moving from a network level assessment and proposing to be replaced by one at a granular, asset level.

The timeline for submission remains extremely challenging so where possible, we support a sector specific approach to resolve these issues in time for submission on the 31st July.

We have provided detailed comments to the consultation in question in the appendix of our response.

For queries in relation to our consultation response please contact myself or Tamsin.Kashap@nationalgrid.com.

Yours sincerely,



Tony Nixon
Head of Gas Transmission Regulation, National Grid

NGGT – Consultation Response

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 agree that, following the publication of the NOMs Incentive Methodology in 2018 and the engagement leading up to this consultation, the correct areas have been identified requiring further review. We have split the areas of review into five categories aligned to Ofgem's consultation:

1. Relevant Risk Changes
2. Approach to derive associated costs
3. Deadband
4. Interaction with other mechanisms
5. Timeline

We detail our views below:

1. Relevant Risk Changes (Normalisation), order of considering Relevant Risk Changes and elements to which Relevant Risk Changes should be applied:

We agree with the relevant risk changes categories included and understand the logic used to order the application of these as part of normalisation. We agree with the inclusion of the risk change category for pre-RIIO-1 work following our feedback supplied to Ofgem in previous engagements and that the relevant risk changes are addressed through adjustments to the targets.

Load-related additions (Impact of Change in Asset Base over RIIO-1)

We would like to note that the term 'load related additions' is not correct in this context for National Grid Gas Transmission (NGGT) but agree that the new term 'Impact of Change in Asset Base over RIIO-1' is more appropriate.

The scope of works within 'Impact of Change in Asset Base over RIIO-1' for NGGT includes a range of investments that are not driven by Asset Health. Non-Asset Health (non-AH) investment. This encompasses load related work, additions and removals driven by emissions or other legislation as well as asset disconnections and decommissioning (except where there was a specific condition-driver for this work which was funded through the Asset Health allowance). Disconnections and decommissioning for NGGT have been more prevalent than new additions during RIIO-1.

All non-AH driven investment¹ was removed from our rebased monetised risk target as part of the rebasing process². We understand that Ofgem wishes to include this information in the data template, but it is important that the risk impact of non-AH investments should not be used when assessing performance against our rebased target. Our licence condition is to deliver an absolute monetised risk target using Asset Health funding for the 37 Secondary Asset Classes (SACs) in scope for monetised risk as per our NOMs Methodology and therefore we will be held neutral for any risk increase/reduction delivered through non-AH investments.

Ofgem has reissued the 'Closeout Submission Instructions and Guidance' (Guidance) version 1.1 and the 'Closeout Data Template' (Data Template) version 1.1 on the 17th May 2021 with changes relating to the treatment of load related additions to ensure all asset additions and removals can be captured in the Data Template and are not limited to load related additions. The relevant risk change category has been renamed to 'Impact of Change in Asset Base over RIIO-1'. These changes also need to be reflected in the relevant sections of the 'NOMs Incentive Methodology' document (Methodology), for example in chapter 3 and appendix 1. We agree with these changes and we have since engaged with Ofgem to ensure the Data Template is set up as intended and allows us to reflect our performance in RIIO-1.

Following the updated Guidance and Template we have discussed our approach with Ofgem and propose the following changes to be included in the final version of the Data Template and Guidance:

- Section B - Original (Start RIIO-1) NOMs Asset Base: Our RIIO-1 asset base should be aligned to our actual start position, which means the total network risk of the network at the beginning of RIIO-1 including work carried out before the 1st April 2013, but after submission and approval of our RIIO-1 business plan, which was based on our risk on the network in 2010/11. We have used the 2013 Regulatory Reporting Pack (RRP) as our RIIO-1 start position as it represents our asset base as it was at the start of the regulatory period and accounts for all the pre-RIIO-1 work as it would have been applied to the existing assets to create the 2013 RRP tables. In order to meet the Ofgem requirement to normalise the target, rather than delivery, it is not possible to present both the actual and 'non-normalised' start position (i.e. the asset base as it was at the point of our RIIO-1 business plan submission) as they are different and only the actual position represents a true picture of our asset base at the beginning of RIIO-1. Per rebasing, the B position should represent all assets without the non-AH related changes, which were added or

¹This means the investment driver was not Asset Health (condition driver) and therefore had a different funding mechanism in RIIO-1.

² <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-proposal-approve-rebased-network-replacement-outputs-and-modify-special-condition-7e-gas-transporter-licence-held-national-grid-gas-plc>

removed by a non-AH driven investment. This maybe a unique issue for NGGT due to the way we have rebased our RIIO-1 network risk targets (i.e. starting from the RIIO-1 business plan and monetising this start position, rather than using the actual RIIO-1 start position as detailed above) and may not be applicable for other sectors. Therefore we recommend to adjust the wording in the Guidance (version 1.1) for tab '3.2_Delivery_[ET, GT, or GD]' in the Data Template for section B. from "The asset base underlying the data reported in this section must align with the asset base underlying the target data reported on worksheets 3.1 and 3.1.1." to "The asset base underlying the data reported in the section must align with the actual asset base on the network at the start of RIIO-1."

- Section C - Impact of Change in Asset Base Over RIIO-1: To account for the effect of non-AH driven additions and removals, it is necessary to compare section A to section B (as Ofgem suggests, $C = (A-B)$). However, the value of the non-AH removals which comes from comparing the two without positions should be a negative number. Section A has more assets as it includes the non-AH asset additions, so $(A - B)$ is positive so logic dictates the impact on non-AH removals must be $(B - A)$. As discussed with Ofgem, the Data Template calculates section $C = (A - B)$, but the Data Template needs to be amended to be multiplied by (-1) to reflect the reduce risk as intended. Comparing the two with positions as $(A - B)$ is fine to calculate the value of the additions caused by non-AH related drivers.
- Delivered position (3.3.1) should pull through from section B: We will include all our non-AH additions and removals in the section A - Total Network Asset Base (i.e. Total asset base at end RIIO-2) and remove the assets that have non-AH removals and additions, as per the rebasing principles, as part of normalisation (relevant risk changes) for section B as our delivered position. By normalising, we deduct the effect of non-AH changes from the target. The delivered position that is being compared against our normalised target should also deduct these changes so we are comparing the two relevant sets of interventions (RIIO-1 business plan planned interventions against actual interventions carried out in RIIO-1) on the same asset base which has the same start position and 'Without Intervention' position. This delivered position is B, as the difference between section A and section B is the normalisation factors (relevant risk changes) which is applied to the target, and also applied in section B by removing Non-AH driven additions and removals.

Treatment of slower/faster deterioration:

We would like to suggest that it may be worth distinguishing between 1) "deterioration" resulting in a higher number of required interventions 2) "deterioration" resulting in a higher level of asset risk

than predicted. For a network such as the NTS, where there are relatively few reactive failures per asset, a long time series of data is needed to measure deterioration robustly and we would not expect a difference between the deterioration value used to set the target and that experienced. Higher volumes will most likely be due to an increased frequency of random failures over a relatively short time period, and if this is indicative of an underlying deterioration increase, this can only be assessed over a period of time whereby the numbers of observed failures (and the increased annual frequency) is statistically significant. For clarity, we have assumed the same deterioration rate for rebasing and actuals.

2. Approach to deriving associated costs:

Following the Ofgem working groups in early 2021, we understood that we would support Ofgem's development of a methodology for deriving associated costs, but we did not expect this to be part of the formal submission of our NOMs performance report in July 2021. This additional requirement is adding a significant amount of work to an already very challenging timeline set by Ofgem. The lack of clarity on the materiality threshold for proceeding to the next stage of submission potentially results in a lot of unnecessary time spend on cost proposals that might never be used. We would recommend removing this as a formal requirement from the 31st July 2021 submission and continue to approach this as a collaborative work stream with Ofgem on the development of calculations for associated costs.

We are concerned that the proposed asset level cost assessment is an alteration to the established NOMs incentive methodology. NGGT has an absolute monetised risk target on a total network level and our Asset Health allowances have been agreed at a total level covering all Asset Health spend, not just the direct delivery of our monetised risk target. An allowance at primary or secondary asset level has never been set. We therefore strongly recommend that any calculation of associated costs, especially a Unit Cost of Risk (UCR) approach, needs to be considered at a whole network level. This is because 1) our rebased target is set at network level and has been planned and delivered on a 'whole network basis' over the period 2) the mechanism is designed to encourage risk trading, therefore any "silo" approach to calculating costs of over- or under-delivery is not appropriate.

It is important to consider that there is also a disconnect between the asset with associated allowances and the delivery of monetised risk. Our network risk targets were rebased in 2019 and not approved until July 2020. Following on from the rebasing to monetised risk, our Asset Health allowances were not changed to allow any direct link to the element of Asset Health delivering monetised risk benefits – i.e. Asset Health interventions carried out at 37 SACs only. Hence there is a disconnect between allowances and monetised risk outputs at the point of target setting, which will be localised to specific asset categories. This has resulted in some secondary asset classes

not having any assumed allowances but delivering a material risk output. It should be noted that the 47 SACs that NGGT report against annually as part of RRP were established many years before the concept of monetised risk was developed.

We would also welcome further clarity on how Ofgem is going to derive the financing costs incurred by the licensee in advancing or delaying investments and if this should form part of any methodology calculation associated costs for over -and under-delivery.

Ofgem is proposing for each sector to submit an individual approach for calculating costs of over- or under-delivery. We would like further clarity on how Ofgem will ensure all sectors are being treated fairly. The fact that in RIIO-1 we are using monetised risk rather than long term risk benefit in RIIO-2 means that a potential UCR mechanism will be more highly geared (for NGGT) than the mechanism agreed for the NARMS funding adjustment mechanism. We will consider this as part of our proposed approach, but any normalisation needs to deliver fair and equitable reward/penalty opportunity across the RIIO-1 period.

3. Materiality Threshold ('Deadband'):

As highlighted in previous communications, we remain very concerned that the deadband has not yet been set at this stage of the process. With the lack of a confirmed deadband we are unable to quantify our performance against target and this doesn't allow suitable time to prepare any over- or under-delivery justifications.

The consultation indicates that the materiality threshold will be based on quality of data and robustness of information, however, the information in the submission will not enable Ofgem to derive any metrics that would allow to assess quality, such as confidence bands around each data point. Ofgem could assess completeness and undertake a qualitative assessment of quality, but there is no definition of 'robust' and no data to directly quantify a materiality threshold.

Following our engagement with Ofgem on 13th May 2021, we would like to propose that a sector specific approach is taken, and we request that Ofgem provide a clear definition of the purpose of the deadband, and some core principles for how a value may be derived. This would enable us to swiftly support Ofgem in the creation of a fair and mutually agreed dead band valuation for NGGT.

We do agree that no single asset category should drive the outcome of the deadband assessment, if proven to be unjustified. However, the size of the dead band, if its purpose is to assign a level of confidence/uncertainty to the target, needs to be driven by data. So, if a single asset category

	<p>dominates the overall reported risk position, and the data used to return this risk value is uncertain, then that single asset category should dominate the overall dead band value. Any other course of action is statistically incorrect and arbitrary.</p> <p>4. <u>Interactions with other mechanisms:</u> We do not believe there are any interactions with other mechanisms for NGGT, which have not been already addressed through relevant risk changes, in particular, “the Impact of Change in Asset Base over RIIO-1” category.</p> <p>5. <u>Timeline:</u> Please see our response to question 5.</p>
<p>Question 2: Are there are other areas of the methodology that require changes that have not been outlined in Section 3?</p>	<p>The Methodology and the Guidance documents include sections of narrative requirements for the stage 1 and 2 submissions. In section 3.1 of the Methodology document it states that the narrative should be focused on outturn performance and an explanation of relevant risk changes including why they have been applied, and how values have been derived. Appendix 1 of the Methodology document gives further detail on the content of the performance report at stage 1 and 2, which also mentions the proposed methodology for calculating associated cost for over- and under-delivery. Chapter 8 of the Guidance lists a proposed structure for the narrative which also includes the proposed methodology for calculating associated cost. A simpler and consistent approach would help reduce the need to interpret the narrative requirements in the different documents. We have interpreted the available guidance to comply with the narrative requirements for the stage 1 and 2 submission as follows: a performance related narrative following the principles outlined in appendix 2 of the Methodology, a data table narrative following the structure outlined in chapter 8 of the Guidance and a potentially standalone proposal on the methodology for calculation associated costs.</p>
<p>Question 3: Do you agree with the proposed modifications to the NOMs Incentive Methodology?</p>	<p>We agree with the changes made to the NOMs Incentive Methodology document as such that the document now reflects the areas which still require Ofgem decisions.</p> <p>We welcome that the updated timeline has now been reflected in the document detailing the requirements at each stage of the closeout process with associated dates of decision making.</p> <p>As mentioned above, we agree with the inclusion of the relevant risk category for “pre-RIIO-1 work true-up” or “pre-RIIO-1 work changes” where these have not already been addressed through rebasing”. The recent changes to the relevant risk changes issued with version 1.1 of the Data Template and Guidance will need to be reflected in the relevant section of the Methodology document.</p>

However, we remain concerned that key aspects of the methodology, in particular, the deadband in particular are still ambiguous and the calculation of associated costs for over- and under-delivery is potentially altering the principles of the Methodology set at the beginning of the price control. On the elements of the Methodology where Ofgem still needs to make decisions we would welcome further engagement, for example further clarity on how Ofgem is planning to set the deadband and what we can do to support this process to allow an earlier indication of our RIIO-1 performance outcome.

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

While completing our dry run and preparing our July 2021 performance report submission, we have discovered the following issues with the Data Template:

All tabs relevant to GT starting with 3:

- Work load volumes: we have historically done all these to 0 decimal places. This is only relevant for SAC 33 for pipelines, we have not recorded changes less than 1 km.
- Monetised Risk is not in the range of millions of pounds for individual SAC and PAC combinations with the exception of pipelines, for NGGT we will report in Risk £ rather than millions. This is evident from the rebasing exercise where our total risk is £5.8m (Guidance document 1.4 points 10,11).
- There seems to be a unit discrepancy between the licensee input tabs. For clarity we believe the following units should be applied:
 - 3.1_Targets_GT – Risk £ **not** £m
 - 3.1.1_Targets_Volumes_GT – Risk £ **not** £m
 - 3.2_Deliver_GT – Risk £ is correct
 - 3.2.1_Delivery_Volumes_GT – each SAC's has its defined unit of measure **not** £m
 - 3.3.1_Normalisations_Targets – Risk £ **not** £m
 - 3.3.2_Normalisations_Delivery – Risk £ **not** £m

Tab 3.3.2_Normalisations_Delivery (all sectors):

Normalisation position for delivery: the 'Without Intervention' position pulls data from the Normalised Targets. For NGGT these are the same position as we should be comparing two intervention plans (actual interventions and planned interventions in RIIO-1 on an equivalent asset base). We suggest to pull this data directly from the relevant 3.2_Delivery_[ET, GT, or GD] tab from the B position.

Following the reissued 'Closeout Submission Instructions and Guidance' (Guidance) version 1.1 and the 'Closeout Data Template' (Data Template) version 1.1 on the 17th May 2021 with changes

relating to the treatment of load related additions, we note the following changes to be made to the Guidance and Data Template, which we have detailed further in response to question 1:

- The relevant risk change category has been renamed to 'Impact of Change in Asset Base over RIIO-1'. These changes would need to be reflected in the relevant sections of the 'NOMs Incentive Methodology' document (Incentive Methodology), for example in chapter 3 and appendix 1.
- We recommend to adjust the wording in the Guidance (version 1.1) for tab '3.2_Delivery_[ET, GT, or GD]' in the Data Template for section B. from "The asset base underlying the data reported in this section must align with the asset base underlying the target data reported on worksheets 3.1 and 3.1.1." to "The asset base underlying the data reported in the section must align with the actual risk on the network at the start of RIIO-1." (for further detail on the reasoning, please see our response to question 1).
- The Data Template calculates section C = (A- B), but the Data Template needs to be amended to be multiplied by (-1) to reflect the reduce risk as intended.
- Delivered position (3.3.1) should pull through from section B.

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 acknowledge the clarity given by Ofgem in this consultation on the timeline for the NOMs closeout process. Nevertheless, we would like to highlight that there was opportunity to allow more time to resolve the outstanding areas highlighted in the December 2018 version of the NOMs Incentive Methodology. We highlighted our concerns on the outstanding areas throughout 2020 in the RIIO-2 licence working groups and formal consultations, but the July 2021 submission date for the stage 1 and 2 submission has remained unchanged throughout the RIIO-2 licence consultation process. The outcome of this consultation now won't be confirmed until the 30th June, just four weeks before submission. This makes it extremely challenging to complete the final templates and undertake the necessary assurance and sign off processes.

Furthermore, we are concerned that there will not be a decision on stage 1 and 2 until 16th September 2021 which then leaves 2.5 months for our submission of justification cases, associated costs and associated governance and assurance complying with the requirements outlined in appendix 2 of the Methodology.

Ofgem won't make a final decision on our delivery against targets until 30th November 2021 which will leave only one month to finalise our submission but leaves Ofgem four months to assess our submission.

Overall the process and potential changes to proceed through the submission stages are not well planned to allow for the necessary engagement on this topic.