

Office of Gas and Electricity Markets (OFGEM)

FAO: Thomas McLaren
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Dear Thomas,

Consultation on Network Asset Risk Metric (NARM) Regulatory Instructions and Guidance (RIGs) and NARM Regulatory Reporting Pack (RRP) to apply during RIIO-ET2, RIIO-GT2, and RIIO-GD2.

I am pleased to enclose a response from SSEN Transmission¹ to Ofgem's consultation on the above publications. While the focus of this consultation is the NARM RIGs and RRP, we also have concerns on the NARM mechanism in general which are relevant and inform the current consultation response. We therefore set these out first.

General NARM Concerns

NARM has been developed in RIIO-2, building on the NOMs monetised risk approach developed in the latter years of RIIO-1. It is the primary measure for defining our asset management outputs. However, as we have outlined previously, the NARM mechanism is still immature and not wholly fit for purpose. We see this demonstrated by multiple network companies having to ring-fence certain asset management activities to be dealt with outside of the NARM mechanism.

The current flaws of the mechanism can best be demonstrated using an example from our RIIO-T2 Outputs. One scheme (Harris – Stornoway OHL scheme) represents 72% (R£6,319m out of R£8,833m) of our target risk reduction over five years. However, this project only represents 5% (£36.62m) of our £752m baseline funding provided to remove and reduce asset risk through replacement and refurbishment across our extensive network. This illustrates a flaw of the Monetised Risk and NARM methodology which has not adequately been considered thus far i.e., Monetised Risk, as currently developed, does not reflect the real world. Monetised risk as currently developed does not reflect the real world.

Due to the individual configuration of the Transmission networks across Great Britain some asset interventions generate large monetised risk benefits for a relatively low cost. An example is the asset interventions on radial OHL circuits example provided above. On the flip side, there are other asset management schemes which generate a relatively low monetised risk output but require significant investment to remedy the underlying condition issues.

This demonstrates four major concerns for network companies and the consumer.

1. **Need** - If used on its own, then it can drive the wrong behaviours from Network Companies and not represent the interest of the consumer. Monetised risk alone can never be used to demonstrate the need for an asset intervention. We agree that it can be used as part of a much wider toolbox of indicators to demonstrate and evidence asset interventions. However, robust asset stewardship of our networks, based on understanding of the condition of individual and groups of assets, is required to target investment and delivery where it is required.

¹ References to SSEN Transmission encompass the licenced entity Scottish Hydro Electric Transmission plc Registered in Scotland No. SC213461.

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2. **Incentive** - That network companies are actually incentivised by Ofgem’s NARM mechanism to intervene on schemes which generate a large monetised risk benefit but with a relatively low cost, regardless of the actual need for intervention on that particular part of the network. Currently, the incentive in terms of output delivery would be to repeatedly intervene on our OHL radial circuits due to the large monetised risk which is generated by interventions on this part of the network. We could deliver the price control outputs but not address a growing risk issue on the core of our net zero network. This could also act as a disincentive to address an emerging asset condition issue which has a relatively low R£ value but a higher cost.
3. **Mechanistic adjustment** - The NARM Funding Adjustment mechanism is fundamentally flawed. As we have illustrated above, and in previous evidence provided, the Unit Cost of Risk Benefit (UCRB) approach simply does not work for our project-based approach to Non-Load investment. Therefore, the UCR Funding Adjustment Mechanism is rendered unfit and the outputs unfair for us or our consumers.
4. **Inappropriate gains / losses** - The illustration above demonstrates that trade-offs or substitutions could lead to a risk of windfall gains or losses in RIIO-2. Due to the flaws with the NARM Funding Adjustment mechanisms, Network Companies could potentially benefit or be penalised by windfall gains and losses by undertaking trade-offs from the schemes included within its Business Plan. This was never the purpose of developing a common unit of measurement by which different asset intervention decisions could be compared.

Points 3 and 4 have been acknowledged to some extent by Ofgem by the introduction of “Clearly Identifiable Projects” where Ofgem will assess projects on a project-by-project assessment in exceptional circumstances. However, unless Ofgem treats every asset trade off or substitution in this manner, then the risk of unexpected an unwarranted outcome remain.

NARM RRP

Following a detailed review of the draft NARM Regulatory Reporting Pack (RRP), our primary concern is that the requirements to provide significant additional information relating to our T2 activity does not align to the outputs we, or any other TO, have within our price control settlement. The majority of the information that Ofgem is looking to collect within the RIIO-T2 NARM RRP will provide volumes of asset interventions and a current snapshot of monetised risk. Our RIIO-T2 output targets are based on the NARM output of Long-Term Risk Benefit (LTRB). These are not the same measure.

We have included more detailed comments on our concerns within the Appendix below. We have also provided an issues log alongside this main response with more detailed feedback and comment on specific tables.

We are generally supportive of Ofgem’s overall objective to use regulatory reporting submissions to provide insight on, and transparency of, the value customers realise in the delivery of our outputs. However, the level of data collection and information needs to be proportionate to the benefit realised by Ofgem and consumers. We are concerned that proposed reporting pack is asking for significant levels of detail without also providing the required tracking of regulatory outputs on an annual basis.

Our key concerns from the consultation are:

- Ofgem is not clear on the purpose of the NARM RRP in its consultation. It is unclear whether the purpose of the RRP is it to track performance against our NARM target and/or be used as a dataset for subsequent price controls. In a recent cross sector NARMs RRP working group Ofgem intimated that the data collection is needed with a view on setting RIIO-3. A clear purpose is essential in order to evaluate, through consultation, whether the RRP pack is fit for purpose. This should be set out prior to designing the pack.
- Our view is that the pack should, at a minimum, serve the first purpose - tracking delivery of performance against outputs (price control deliverables). As it is designed the pack does not track performance against outputs.

- If the pack is to serve as a data set for future price controls, we have concerns that Ofgem’s approach appears to be focused on collecting data in advance of setting out a strategy of how this data will inform future price controls. The lessons learned from the RIIO-T2 process is this will likely lead to a mismatch of ambition and available data.
- Ofgem has created a cross sector NARMs RRP for two sectors that track different outputs. Gas Distribution Networks (GDNs) use Monetised Risk whereas Electricity Transmission (ET) use Long Term Risk Benefit. We are concerned that the ET networks are having to provide both a snapshot of monetised risk and Long-Term Risk Benefit. We should only be capturing the latter to track output delivery. We believe it unnecessary and inefficient to collect data that does not serve a purpose or may be used incorrectly at a later date.
- Ofgem states that *“For the first year of NARM annual reporting, we have designed and structured the RRP data templates to be an evolved version of the NARM Business Plan Data Template (BPDT)”* and *“we expect to be able to redesign the NARM RRP in line with the agreed data schema for 2022/23 reporting.”* This means that the limitations of this reporting pack are recognised with the consequence that it will be used for only one year. This in turn recognises that further changes to systems will be required following the redesign. We require clarity from Ofgem on how significant this redesign will be after year one. We are concerned that the significant time, effort, and expenditure required to update systems and work processes for this new pack will be required again if the pack significantly changes.
- Ofgem’s expectations for year one reporting should be that the networks will endeavour to fill out the pack on a best endeavour basis. Given the limited engagement, timescales and guidance, Ofgem has to be cognisant that the reporting consistency will therefore be different across the networks, as will the ability to provide the required data vary across companies.
- We do not believe that it is an efficient use of expenditure or resource to report knowing that the information provided will then have to be modified in the subsequent period as guidance is updated. An efficient alternative would be to delay the reporting by a few months, set an information gathering strategy for RIIO-T2 (outputs and future analytics) and then release a pack with guidance that enables consistent data to be provided from year 1 onwards of the price control period.

We are happy to commit to continued engagement between now and Ofgem’s decision on the RIIO-T2 NARM RRP data templates and associated guidance to ensure our issues are addressed.

Yours sincerely,
Nicki Reed

Appendix – Detailed Key Concerns with NARM RRP

1. Purpose of Tables

There has been a significant change in the reporting tables framework. The data tables required within the reporting pack have significantly expanded from two tabs (RIIO-T1 RRP reporting tables) to 20 tabs (RIIO-T2 NARM RRP). While we accept that to increase transparency an increased level of data will be required, we are concerned that the increased level of information Ofgem is proposing does not actually achieve that aim.

Our RIIO-T2 NARMs target is based upon a Long-Term Risk Benefit (LTRB) target. However, most of the information that Ofgem is looking to collect within the RIIO-T2 NARM RRP will provide volumes and a current snapshot of monetised risk. This cannot then be used to assess delivery against our RIIO-T2 LTRB target. The increased level of information Ofgem is asking for will not allow it to compare actual LTRB performance against our RIIO-T2 baseline.

We recommend that Ofgem reviews the objective of the NARMs RRP from the perspective of each sector, then establish the baseline content necessary to achieve that outcome. We are keen to work with Ofgem on reworking the pack, but we are aware of the significantly tight timescales to do so.

We have provided our view on the proposed purpose of specific tables within the pack, and how they do not provide Ofgem with the ability to track Long Term Risk Benefit.

Purpose of Table N1.1

Table N1.1 appears to be summarising the monetised risk numbers to then link back to the CV RRP Pack. The guidance asks for *MR Delivered (R£m)* which is the monetised risk value, not the Long-term Risk Benefit (LR£m). While it appears that Ofgem is looking to track LTRB performance within table N1.3 this table does not provide the ability to do so.

For example, it is not clear if it is the actual or forecast LTRB required to be populated within the table. Even if this requirement was clear, there is nowhere within the table that compares actual against forecast LTRB within the table and therefore performance cannot be tracked.

Purpose of Table N1.3

The RIGs state that N1.3 tabs “*Provides relevant detail on type of interventions and intervention options for Monetised Risk Output delivery as well as details of projects or schemes for delivering outputs.*” However there appears to be confusion over the use of Monetised risk and Long-Term Monetised Risk benefit.

For example, the RIGs are not clear how the Outputs (Columns L-R) should be populated. There are references to providing current and forecast intervention year and completed interventions but no clear identification of where actuals or forecasted (at the end of T2) numbers are required. The guidance suggests both data points should be used but there is only space for one.

Purpose of N3 Tables

Ofgem set out within the NARM RIGs that Tables N3 will “*provide a view of the long-term benefit forecast to be delivered by a licensee’s replacement and refurbishment activities over RIIO-2*”. However, again here there is a mismatch between the guidance and the pack.

For example, the RRP pack tracks, in detail, the changes in current monetised risk from the T1 Closeout position to the forecast T2 End Point, attributing the changes to key intervention categories. However, as we have noted above many times monetised risk is not a measure of our set performance targets in T2. This information therefore provides no insight into our performance against target.

Forecasting and reporting Long Term Risk Benefit Annually

We have concerns around Ofgem's expectation that the network companies will be able to provide an updated Long-Term Risk Benefit forecast on an annual basis

- There is no clarity on whether LTRB is intended to be captured on all assets or only interventions within the pack. However, the tables provided for LTRB population are a matrix format, which spans 10 bands and multiple options. If any LTRB is to be populated in these tabs, it should be a single input cell, and have the value from T2 Business Plan.
- The number of potential scenarios and factors that would need to be considered and the material year on year changes that would need to be explained is not efficient or proportionate to the output achieved.
- LTRB is calculated by modelling the interventions as though they occur in the final year of the price control, so except in the case of added or removed projects, the LTRB used in T2 planning will need to be used until the final year where they can all be calculated as actuals.

Our position is that the RIIO-T2 baseline will be the enduring forecast that will be adjusted annually based on actual interventions delivered. We believe this provides the most appropriate and proportionate forecast of LTRB within the reporting templates.

2. Guidance

We are concerned by the consistency of the published guidance. It would appear to be a copy of the Business Plan Submission guidance (20 September 2019) that has not been updated to correctly reflect the passage of time or the requirements of the T2 NARMS RRP.

For example, the guidance under consultation refers to "*remaining two years of RIIO-1 and five years of RIIO-2*" which is a phrase directly from the T2 Business Plan submission guidance². The guidance does not clearly identify the purpose for each of the tables introduced, nor is it clear how some of the requested information will be used. This confirms our concern that the purpose of the reporting pack has not adequately been considered in advance on which the guidance could then have been developed. Furthermore, the guidance provides minimal detail on how cells should be populated, leaving TOs to interpret what is required.

For example, the guidance for populating Table N1.3 with Long-Term Risk Benefit could be interpreted to require forecast at the beginning of RIIO-T2 or actual and forecast LTRB. This could create inconsistencies in population of the tables due to the potential for different interpretations of the high-level guidance. In our view, Ofgem needs to provide greater clarification on the detail and purpose of each of the proposed tables, in relation to assessing performance during the RIIO-T2 period within the guidance document and ensuring consistency in reporting across network companies.

3. Engagement

We are disappointed that a draft version was not released to the TO's nor was there engagement with the network companies prior to the consultation. Our experience within RRP table development is that it is an iterative process. The time left to achieve that is very limited prior to the first submission window. We believe release of a draft NARM RPP pack and RIGs, in conjunction with working groups, would have allowed us to help inform its development before entering the consultation period. This would have helped develop the NARMS RRP Data tables more effectively and identified and fixed the issues in key areas such as the LTRB data tables.

² Section 5, Paragraph 5.1, p27 - *RIIO-2 Business Plan Data Template (BPDT) Guidance for Network Asset Risk Metric (NARM) Tables – for Electricity Transmission, Gas Transmission, and Gas Distribution*

Ofgem has intimated that it will be looking to engage with the network companies post consultation. However, given the material issues and work still required to be resolved as this is a cross sector NARMs RRP, we have significant concerns that this will not be completed in time for July 2022.

We believe the Data Assurance Guidance (DAG) should acknowledge the impact of gaps in guidance, the scale of the network work required in the short time until first submissions in July 2022 and the potential for the pack to be redesigned after year one.

4. Timescales

Ofgem must not underestimate the time needed to accurately develop the data tables, guidance and the systems required to complete the proposed data tables fully. The software development required to accommodate reporting requirements, and subsequent changes to these, would be very challenging given the timescales within the price control period.

Given the short timescales to agree and finalise the NARMs RRP before the end of year one, we recommend that Ofgem delay TO submission to later than the 31 July in 2022. This would allow extra time to be able to sort out the purpose and tracking issues we identify above. Delaying the submission of the NARM workbook does not have an impact on other mechanisms such as the Annual Iteration Process (AIP) and will be in the benefit to the consumers to use this intervening time to create a pack that achieves its objectives. We are also concerned with the interaction with the CV RRP and any delays of populating the CV pack, caused by glossary development, could have a knock-on impact on population of the NARMs RRP. We would welcome discussion with Ofgem on the length of delay necessary to address the concerns raised in this, and other consultation responses.

5. Interface with NARMs CV pack

In our view, there are significant issues with mapping CV annual interventions to the NARM interventions. The volumes set out within, and then transferred from, the main RRP pack detail every intervention, but in the NARM RRP, we are not looking at every intervention required on the network.

For example, load-related works involving 21 lead asset categories will be transferred from the CV RRP to the NARM pack. This will create a mismatch as the NARM interface table will capture lead assets only. Volumes between the CV and NARM RRP packs will not reconcile.

Furthermore, we would note that it is our understanding that only NARM applicable assets will be captured through this reporting; no Load assets are to be included. We believe that the changes required to rectify this issue are within the main Cost and Volume RRP NARMs interface and are captured within our issue log to the CV RRP consultation.