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Ofgem
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9th May 2025

Dear Faysal,

Re: Network Asset Risk Metric handbook: clearly identifiable threshold statutory consultation

Thank you for the opportunity to provide a response to the above noted consultation. Northern Gas Networks (NGN) has been actively involved in workgroups and discussions relating to NARM and appreciate this opportunity to inform your decisions. We have set out our responses to the specific consultation questions in Appendix 1 and, highlight below NGN's pertinent points.

Overall, NGN are concerned that the consultation on CIO/UD and update to the handbook is happening late in the RIIO-GD2 price control and that this should be taken into consideration in assessing NARM closeout. Due to lead times, delivery programmes are now set for the remainder of RIIO-GD2, and we are unable to materially alter our NARM outcomes to react to these updates. NGN consider that the current engagement process around NARM could be improved, including sharing of materials well ahead of working groups (which networks could input to) and consistent follow-up on meetings with minutes and dated actions. These steps would allow networks to jointly work with Ofgem to develop enhancements to the NARM mechanism in a more timely and effective manner going forward.

NGN consider that the unintended consequence of this process is increased and significant subjectivity and regulatory burden of clearly identifiable assessment. As Ofgem note, if delivery element level assessment against Network level UCR is carried out, this may lead to a significant number of programmes triggering the +/-5% threshold, even if networks are within UCR deadband at network level overall. In Gas Distribution, the detailed nature of our NARM models and programme delivery mean that small changes in individual elements often lead to +/-5% UCR movements over many areas. However, at a network level, which we are targeted at, these are likely to balance out and be immaterial individually. NGN suggest additional materiality criteria for consideration for CI based on a delivery element having an impact of greater than, for example, 5% on spend against allowance and/or risk.

Under para 10.5(4) & 10.7(4), it is noted that Ofgem support that the networks propose delivery elements of CI over or under delivery, rather than automatic classification based on the threshold. NGN continue to agree with this. However, Ofgem will also carry out a similar assessment and there is nowhere in the consultation documents or updated handbook to set out clear guidelines or definitions around this process (apart from the UCR +/-5% threshold), which would make this process highly subjective and subject to high uncertainty. This leaves us unable to project performance to our business leaders and open to significant uncertainty around allowance. NARM effectively becomes an ex-post assessment for what is a significant proportion of networks spend on BAU investment, which adds significant regulatory burden to both networks and Ofgem.

I hope these comments will be of assistance and please contact me on details provided below should you require any further information on this response.

Yours sincerely,



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the network**

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Appendix 1 – NGN consultation questions and responses.

Question 1: Do you agree that the draft NARM Handbook aligns with our amendments proposed under the document titled “Qualifying criteria for Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery under the NARM Mechanism”? Where you disagree, please clearly set out your reasoning and specify other considerations/factors we should take into account.

NGN’s view is that the latest draft handbook broadly aligns with the decided amendments. There are, however, some key areas that require further review and additional clarity to ensure that:

- NARM Funding Mechanism operates as intended
- Application of the mechanism is pragmatic and proportional
- There is alignment between the latest Handbook and guidance supplied by Ofgem during cross-sector and sector specific working groups

These are detailed below, under the relevant paragraph within the DRAFT_NARM_Handbook v4.0.

Paras 10.5 (4) and 10.7 (4)

As per the consultation response submitted on the 16th of August 2024, Northern Gas Networks (NGN) do not disagree with the proposed 5% threshold per delivery element which is now recorded under sections 10.5 (4) and 10.7 (4) of the DRAFT_NARM_Handbook v4.0. It remains paramount that a pragmatic and proportional approach is taken and the programmes that satisfy the criteria under sections 10.5 and 10.7 do not automatically become Clearly Identifiable (CI). In gas distribution in particular, each delivery element can represent a minor contribution to costs and risk, and these can be sensitive to changes in delivery. It is NGN’s continued position that if these individual instances balance to within 5% of targets at a network level, then only material and exceptional deviations from targets should be allocated to CI. This is important, because there is a real risk of an unintended and disproportional regulatory burden being placed upon Ofgem and the Gas Distribution Networks (GDNs).

To provide some more context in explaining the aforementioned unintended consequences it is important to understand the various terms referenced within section 10. Sections 10.1 and 10.2 of the NARM Handbook equate “delivery element” to “projects”, “schemes” or “programmes”. For Gas Distribution (GD), only programmes are relevant, thus “delivery element” equates to a “programme” and, for NGN, a “programme” is an individual row in the Network Asset Risk Workbook (NARW) v9.0; there are 48 A1 funded programmes of work defined within the NARW v9.

The CI criteria under sections 10.5 (4) and 10.7 (4) in the DRAFT_NARM_Handbook v4.0 prescribes that the Unit Cost of Risk (UCR) of the over or under delivery element, or programme for GD (see above), is compared against the baseline UCR of a “given risk sub-category”. As risk sub-categories do not apply for GD (specified in multiple sections of the NARM Handbook, including 4.6 and 7.7), every programme outturn UCR would be compared against the network level UCR. **These are not comparable.** Therefore, if CI mechanism is activated, all programmes will fall outside of the deadband at network level, potentially subjecting all GD investment to ex-post programme-by-programme assessment, which the automatic funding adjustment was designed to avoid. We understand that replacing the automatic funding adjustment is not the intention of the CI mechanism, therefore we believe that the existing qualifying criteria under section 10.5 and 10.7 requires further clarity to ensure an objective, targeted and efficient identification and assessment, reserving ex-post programme-by-programme assessments for material deviations only, in line with the guidance issued by Ofgem during the sector-specific working groups on this subject. Ofgem should consider materiality thresholds for delivery elements to be considered for CI based on their proportion of risk and allowances, e.g. 5%.

Our interpretation of the guidance within the NARM Handbook, specifically Figure 4 and sections 10.1/10.2, suggests that CI aims to separate out clearly identifiable over or under delivery. To apply, over or under delivery must first be present; this can only be established using a measurable output, which, for GD, is in the form of network level Network Risk Output (NRO) or UCR. Therefore, it is our understanding that if a GDN is within the network level NRO or UCR deadband, there is no clearly identifiable over or under delivery to be separated out. In such instance, GDNs are still required to provide a level of justification through a NARM Closeout Report to be assessed by Ofgem, therefore customers are afforded protection from any unjustified

costs. If GDN's outturn network level UCR is outside of the baseline network level UCR deadband, over or under delivery elements should be identified by the networks through their assessment of baseline and outturn data and then chosen by the Authority from the available selection as illustrated by Figure 4. Regardless, the guidance for identification of CI programmes in this instance requires refinement as explained in the above response.

Para 7.12 (proposed para 7.10 in v4)

As in the above response, we assume programmes are defined as the individual rows in the latest NARW (v9.0 for NGN). This may benefit from clarification in the Handbook for any future editions. Currently, paragraph 7.10 in DRAFT_NARM_Handbook v4.0 only references projects, but based on the wording in the summary of proposed amendments supplied within the consultation document, we understand this to mean projects, schemes and programmes. For complete clarity and to be consistent with other sections in the document referencing projects, schemes and programmes, this paragraph would benefit from an amendment to include 'delivery element' to cover all three terms.

NGN accept that the cost and outturn NRO are to be provided at programme level, consistent with the NARW submission, and agree that the wording has been amended to clarify this. However, we would like to reiterate, as per the previous consultation point above, that programme level UCR is not comparable to the network level UCR, therefore it remains paramount that a pragmatic and proportional approach is taken and the programmes that satisfy the criteria under sections 10.5 and 10.7 do not automatically become "Clearly Identifiable" (CI).

Additionally, the guidance and templates should be provided as soon as possible as the close out process is fast approaching.

Para 10.5 (2)

This paragraph only appears to apply to ET/ED as it is referencing a "project", but not "programme" in both, the DRAFT_NARM_Handbook v4.0 paragraph 10.5 (2) wording, as well as the wording within the consultation document itself. This is welcome as baseline programmes are fluid and the scopes change depending on asset management needs. For example, the governor demolition programme for NGN may not achieve the risk reduction or volume when compared to the baseline proposal, but this is simply based on the fact that there have not been as many governors to decommission as initially anticipated. Instead, additional governors are replaced or refurbished in response to engineering need, which is in the best interest of customers.

Para 7.14 (b) (proposed para 7.12 (b) in v4) & Table 5: Clearly Identifiable Over-Delivery and Under-Delivery terms

This paragraph defines the term CIOOD as Network Risk Output from over or under delivery elements with respect to the relevant risk sub-categories. As per response above, according to sections 10.1 and 10.2, "delivery element" equates to a programme in the GD context and a programme is a single line within the NARW. This wording suggests that programmes of work identified and confirmed as CI fall within the CIOOD definition, rather than the intended portion of NRO representing an under- or over-delivery relative to BNRO, including the associated work and costs. The aggregation described in paragraph would apply across the network level interventions for GD as there are no risk-subcategories for GD.

Furthermore, the definition of CIO_{OD} would benefit from clarification around the relationship between CIO_{OD} and CIO_{OR}.

Para 7.14 (g) (proposed para 7.12 (g) in v4)

Paragraph 7.14 (g) does not exist in DRAFT_NARM_Handbook v4.0, instead paragraph 7.12 appears to be relevant, with subparagraphs (h) and (i) being added in. Subparagraph (i) specifically mentions JUS (%) weighting. The section appears to suggest that the overall justification percentage (JUS) will be calculated by creating a weighting against each project based on its contribution to the final Outturn Network Risk Output (ONRO). Firstly, the wording in the paragraph should be extended to cover programmes and schemes to be

consistent with other guidance, making it clear that the intention is for the guidance to apply to all sectors. Also, the summary in the consultation document suggests that the intention of the paragraph is to base the weighting on the project's or programme's "relative **justified** contribution to the NRO **over- or under-delivery**". This differs from the wording in DRAFT_NARM_Handbook v4.0, which appears to suggest that the total project's ONRO would be used in the calculation. This could benefit from a worked example to illustrate how the JUS (%) would be worked out in practice.

More broadly, the clarification being offered through the changes made in the DRAFT_NARM_Handbook v4.0 is still causing some concern. Subparagraph 7.12 (i) suggests that an independent justification assessment would be required for every project or programme "that has seen an under-delivery or under-delivery" (please note, wording implied as actual wording is erroneous). This section fails to reference the deadband, therefore implying that **any** under- or over-delivery would make the project/programme/scheme subject to the "independent justification assessment". This omission can lead to unintended and extensive regulatory burden, therefore we would recommend a further edit. Also, the concept of "independent justification assessment" is not defined, so it is unclear who and how will carry out this assessment and against what criteria, therefore causing concerns about subjectivity and lack of clarity. Finally, for GD specifically, it is still unclear what the outturn UCR or NRO would be compared against; the network level UCR/NRO and programme level UCR/NRO are not comparable and the programme level UCRs/NROs have not been established as target figures. If individual programme UCR/NRO is intended to be used as a baseline target, this would constitute a significant change to the initial proposal (network level NRO/UCR being the only targeted deliverables for GD) an appropriate consultation and associated testing is required. We do not believe this has been undertaken and, at such a late stage of the price control, it would not be possible to undertake such an exercise effectively. Otherwise, for GD, a network level assessment should be completed and **only** if there is over or under-delivery outside of the deadband that is material (e.g. greater than 5% contribution to risk / allowance), a programme level review should be considered to understand and assess the drivers for the over- or under-delivery. The guidelines for such assessment should be well defined, which the current version of the DRAFT_NARM_Handbook v4.0 does not provide.

Appendix 4

The examples contained in appendix 4 are very helpful in illustrating possible scenarios when applying the NARM funding mechanism methodology. The comments and queries that arose through the review process are listed below.

Paragraph 1.2

This paragraph notes that "...[the] worked examples do not form part of the NARM Funding Adjustment and Penalty Calculation Methodology." We would welcome some clarification on what is the intention of this note.

Example 1: Justified Over-Delivery scenario

The example contains four projects, flagging two as either CI over or under delivery, noting that these projects meet the CI criteria; presumably, this is the criteria listed in sections 10.5 and 10.7 of the DRAFT_NARM_Handbook v4.0. We are assuming that criteria 1, 2 and 3 are met as the detail is not available within the example, however, criterion 4 states that the "element must have an outturn UCR greater than 105%... or less than 95% of the baseline UCR value, for the given risk sub-category". Assuming the four projects make up a risk category, it is unclear why Project 004 has not been identified as CI. This supports our concerns expressed above about the lack of clarity around elements qualifying as CI and the subjectivity within the assessment.

Furthermore, the calculations carried out to work out the Unjustified over-delivery and the Total allowed expenditure are unclear. The formulae in the handbook and the example dictate that certain values defined within the example are used in the calculations, however, the values actually used do not match what is expected. For example, UCROAD = 0.57£/RE, but 0.59 used; and CIXOD = -£0.2m, but -£0.45 used. It is unclear how the values used in the example were derived.

Example 2: Unjustified Over-Delivery scenario

The comment around qualifying criteria for CI as per above commentary still applies. In addition to this, only the over-delivery element is selected and processed as CI; there is no satisfactory guidance within the handbook to explain how this selection is made and what guidelines the regulator will be using to make this decision. It is concerning that the CI mechanism could be used to inflate or deflate the network's ONRO to outside of the deadband, simply based on a potentially arbitrary selection of CI elements.

There are some inconsistencies in the values used in the noted calculations in this example, however, the outcome values appear to be correct as per the recorded formulae.

Additionally, it would be helpful to extend the worked examples to include a clarification around the calculation of JUS (%).

Example 3: Justified Over-Delivery scenario

The comment around qualifying criteria for CI as per above commentary still applies. In addition to this, only the over-delivery element is actually selected and processed as CI; there is no satisfactory guidance within the handbook to explain how this selection is made and what guidelines the regulator will be using to make this decision. It is concerning that the CI mechanism could be used to inflate or deflate the network's ONRO to outside of the deadband, simply based on a potentially arbitrary selection of CI elements.

Furthermore, the calculations carried out to work out the Unjustified over-delivery and the Total allowed expenditure are unclear. The formulae in the handbook and the example dictate that certain values defined within the example are used in the calculations, however, the values actually used do not match what is expected. For example, UCROAD = $0.57\text{£}/\text{R£}$, but 0.59 used; and CIXOD = £0.5m, but £0.25 used. It is unclear how the values used in the example were derived.

Example 4: Unjustified Under-Delivery scenario

There are some inconsistencies in the values used in the noted calculations in this example, however, the outcome values appear to be correct as per the recorded formulae.

Additionally, it would be helpful to extend the worked examples to include a clarification around the calculation of JUS (%).