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

Dear Thomas,

Gas Transmission Network Output Measures Rebasing Consultation

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

As a part of the RIIO-GT1 price control settlement, National Grid Gas Transmission (NGGT) is required to replace specified volumes of certain asset types (Network Output Measures (NOMs) targets), in order to achieve an absolute level of network risk by the end of the price control¹.

NGGT, like all other network licensees, was required to develop a methodology to 'translate' the original volumetric targets into monetised risk targets and to propose monetised risk targets 'equivalent' to the original targets. However, in relation to its monetised risk methodology, NGGT states: "*in terms of modelling absolute levels of risk there is greater uncertainty at present*". As such:

- **The proposed Rebased Targets do not satisfy all the Rebasing Principles.**
- **The assessment of NGGT's RIIO-GT1 performance should be based on the original volumetric targets.**

The proposed Rebased Targets do not satisfy all the Rebasing Principles:

We do not believe the proposed Rebased Targets satisfy all the Rebasing Principles.

NGGT's RIIO-GT1 business plan, published in 2012, was developed to maintain the then current level of network risk² i.e. to deliver an absolute level of network risk at the end of the price control. In the 2018 Decision to not reject NGGT's monetised risk methodology, Ofgem set out the

¹ Asset volumes and associated allowances are set out Special Condition 7E.

² NGGT's business plan – Outputs annex, paragraph 38.

principles NGGT was required to adhere to when rebasing the original volumetric targets (the Rebasing Principles). The second of those principles is that the same principles shall be applied as those used in RIIO-T1 Business Plan³. Ofgem also stated:

It is important that the Methodology is robustly validated and NGGT's existing asset volume targets are appropriately translated to monetised targets, in order that the NOMs Methodology as submitted is used to effectively implement the NOMs Incentive Mechanism and to objectively and transparently inform NGGT's investment planning.⁴ [Emphasis added]

In the Decision, Ofgem acknowledged NGGT's monetised risk methodology better facilitated the NOMs objectives but could not be sure to what extent its modelled outputs can be relied upon until it had been thoroughly calibrated, tested, and validated⁵. NGGT was required to submit a methodology validation report. In that report, published alongside this consultation, NGGT states:

In summary, we are confident that the Sites and Pipelines are fully suitable for modelling the **relative** levels of monetised risk for use in monetised risk reporting and investment planning, if the same assumptions for without- and with- intervention analysis are used. An example of this is asset deterioration, where a higher/lower rate of deterioration will result in higher/lower values of intervention benefit.

In terms of modelling **absolute** levels of risk there is greater uncertainty at present, as assumptions need to be made for some sensitive input variables where there is immaturity in modelling monetised risk or limited historical failure and consequence data⁶.

NGGT further highlights the Pipelines model cannot be confirmed to reporting the true level of absolute risk but the change in risk levels over time (relative risk) is reasonable⁷.

A methodology that can generate robust absolute monetised risk targets is needed to allow NGGT to appropriately translate existing asset volume targets, which were set to encourage NGGT to deliver an absolute level of risk at the end of the RIIO-GT1 price control. NGGT acknowledges its methodology cannot generate robust absolute monetised risk targets. Nevertheless, the methodology has been used to generate the proposed Rebased Targets.

The proposed Rebased Targets are based on the principle of relative risk reduction instead of the delivery of an absolute level of risk, as NGGT's business plan was based on. NGGT has not adhered to the second Rebasing Principle - the same principles shall be applied as those used in RIIO-T1 Business Plan. This means the proposed Rebased Targets do not satisfy all the Rebasing Principles.

³ "Decision to not reject the modified gas transmission Network Output Measures (NOMs) methodology"; Appendix 1:

https://www.ofgem.gov.uk/system/files/docs/2018/06/gt_noms_methodology_confirmation_letter.pdf.

⁴ "Decision to not reject the modified gas transmission Network Output Measures (NOMs) methodology"; page 2.

⁵ ⁵ "Decision to not reject the modified gas transmission Network Output Measures (NOMs) methodology"; Appendix 1.

⁶ "National Grid Gas Transmission NOMs Methodology Validation Report"; page 107:

https://www.ofgem.gov.uk/system/files/docs/2020/03/nggt_noms_model_validation_report_redacted.pdf.

⁷ National Grid Gas Transmission NOMs Methodology Validation Report"; page 113.

The assessment of NGGT's RIIO-GT1 performance should be based on the original volumetric targets:

We have previously explained why assessing network licensees' RIIO-1 performance according to rebased targets is not appropriate⁸. For example, in our response to the *Network Output Measures (NOMs) Incentive Methodology consultation*, we explained that, with less than three years of their eight-year price controls remaining and rebased targets not agreed, transmission and gas distribution companies will not have been 'appropriately incentivised' and will have had little time to respond once targets are agreed. We proposed the incentive should be 'switched off' for those companies, to avoid the material risk of inappropriate gains or losses being created.

Ofgem did not 'switch off' the incentive, stating the rebased targets are meant to be as equally challenging as the original volumetric targets and companies had been responding to the incentive by aiming to deliver the original volumetric since the start of their price controls⁹. On that basis, NGGT has been responding to the incentive by aiming to deliver an absolute level of network risk at the end of the RIIO-GT1 price control.

Targeting the delivery of an absolute level of network risk is not equivalent to targeting the delivery of relative risk. Key differences are set out in the *RIIO-2 Sector Specific Methodology consultation*. Importantly, National Grid considers the approaches to be materially different:

We are concerned that Ofgem's proposal to move the Network Asset Risk Metrics (NARMs) framework from an absolute level of network risk to a 'relative reduction' in network risk, is silent on the more important consequences of this change. These relate to the incentives on companies to innovate and also on the allocation of risks between networks and consumers. Whilst we understand that this detail is still to be determined, these are the central issues for consumers and should have been an explicit part of the consultation. Therefore, until we are clearer on the implications of the proposed reforms, we cannot support a change as we are concerned that costs to consumers will increase.¹⁰

If NGGT has been responding to the NOMs Incentive during RIIO-GT1, it is based on aiming to deliver an absolute level of network risk at the end of the price control. NGGT considers the absolute and relative risk approaches to be materially different i.e. they are neither equivalent nor interchangeable. At this stage, it cannot be said with certainty that NGGT's approach to delivery (e.g. risk trading across asset types or work volumes) would have remained the same had NGGT known it would have been required to deliver relative risk reduction.

As we have explained above, the requirement for volume targets to be appropriately translated into monetised targets has not been satisfied since NGGT's methodology cannot generate robust absolute network risk targets. Notwithstanding our concerns about rebasing targets during the price control, without the capability to generate absolute risk targets, the necessary intrinsic relationship to the allowances NGGT received to deliver those targets is further broken.

⁸ See Centrica's response to the "NOMS incentive methodology consultation":

https://www.ofgem.gov.uk/system/files/docs/2018/06/centrica_response.pdf

⁹ "Decision on the Network Output Measures (NOMs) Incentive Methodology"; page 8:

https://www.ofgem.gov.uk/system/files/docs/2018/12/decision_on_the_network_output_measures_noms_incentive_methodology_2.pdf.

¹⁰ See page 5 of National Grid's response to the "RIIO-2 Sector Specific Methodology Consultation":

https://www.ofgem.gov.uk/system/files/docs/2019/05/responses_f_-_r.zip.

NGGT's methodology and the proposed Rebased Targets cannot be used to effectively implement the NOMs Incentive Mechanism. It is inappropriate for Ofgem to rely on a methodology that cannot generate absolute risk targets or to assess performance based on targets that do not reflect an absolute level of network risk. With less than 12 months of the current eight-year price control remaining, we expect NGGT's out-turn performance to have started to crystallise. We remain of the view that it is inappropriate for targets to be set when out-turn performance has started to crystallise. These factors further increase the risk of windfall gains or losses, neither of which is in consumers' interests.

We hope you find these comments helpful. Answers to the consultation questions may be found in the attached appendix. Please contact me if you have any questions.

Yours sincerely,

Andy Manning
Head of Network Regulation, Industry Transformation, Investigations and Governance
Centrica Regulatory Affairs, UK & Ireland

Answers to consultation questions

2. Do you agree with our view that the Rebased Targets satisfy the Rebasing Principles? (Section 4)

We do not agree that the Rebased Targets satisfy the Rebasing Principles.

NGGT's RIIO-GT1 business plan was developed to maintain the then current level of network risk i.e. to deliver an absolute level of network risk at the end of the price control. In the 2018 Decision to not reject NGGT's monetised risk methodology, Ofgem set out the principles NGGT was required to adhere to when rebasing the original volumetric targets (the Rebasing Principles). The second of those principles is that the same principles shall be applied as those used in RIIO-T1 Business Plan. NGGT was also required to submit a methodology validation report. In that report, NGGT explains its methodology does not produce robust absolute targets.

A methodology that can generate robust absolute monetised risk targets is needed to allow NGGT to appropriately translate existing asset volume targets, which were set to encourage NGGT to deliver an absolute level of risk at the end of the RIIO-GT1 price control. The proposed Rebased Targets are based on the principle of relative risk reduction instead of the delivery of an absolute level of risk. NGGT has not adhered to the second Rebasing Principle - the same principles shall be applied as those used in RIIO-T1 Business Plan. This means the proposed Rebased Targets do not satisfy all the Rebasing Principles.

3. Do you agree with our minded-to decision to approve NGGT's Rebased Targets and modify NGGT's licence in order to substitute them for the Original Targets? (Section 5)

We do not agree with the minded-to decision to approve NGGT's Rebased Targets and modify NGGT's licence in order to substitute them for the Original Targets. The proposed Rebased Targets do not satisfy all the Rebasing Principles.