

National Grid Gas plc. and
other interested stakeholders

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Dear Stakeholders,

Decision to approve Rebased Network Replacement Outputs and to modify Special Condition 7E of the gas transporter licence held by National Grid Gas plc.

On 6 March 2020, we¹ published a consultation² on a proposal to approve National Grid Gas plc's ('NGGT')³ Rebased Network Replacement Outputs and a statutory consultation on modifying the contents of 'Table 1: Network Replacement Outputs' in Special Condition 7E (Specification of Networks Replacement) ('SpC 7E')⁴ of its gas transporter licence.

We received two responses to the consultation. The full responses are published alongside this decision. Following consideration of those responses, we have decided to approve NGGT's Rebased Network Replacement Outputs and to modify SpC 7E in the manner set out in the consultation. The licence modification notice is published alongside this letter. These licence changes will take effect from 10 September 2020.

This letter summarises the background to our consultation, the responses received, our views on those responses, and our decision and reasons for it.

¹ The Gas and Electricity Markets Authority. Ofgem is the Office of the Authority. The terms "Ofgem" and "the Authority," "we" and "us" are used interchangeably in this letter.

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>

³ The terms "NGGT" and "Licensee" are used interchangeably. They refer to the onshore gas transmission network operator (National Grid Gas Plc).

⁴ Special Licence Condition 7E. Specification of Network Replacement Outputs. Part A: Obligation to deliver Network Replacement Outputs

Background: Network Output Measures Rebasing

We have set out the arrangements relating to Network Output Measures (NOMs)⁵ in the licences of all gas and electricity networks licensees. As part of these arrangements, licensees have been set targets that set out the network risk outcomes they are required to deliver through their asset management activities by the end of RIIO-1.

For NGGT, these targets are called Network Replacement Outputs (NROs)⁶ and are set out in SpC 7E. These NROs reflect the impact of the asset intervention workload (usually replacement or refurbishment) that NGGT has been funded to deliver in RIIO-T1, and represent replacement priority targets⁷ to be delivered through interventions on five NOMs primary asset categories (PACs).⁸ These NROs are based on NGGT's own methodology for assessing the health and criticality of its network assets and the impact of its asset interventions on these parameters. We refer to these NROs as the "Original Targets".

However, because NGGT's Original Targets were volumetric based, it does not allow for robust like-for-like comparisons across different PACs. On 19 June 2018, we published our decision to not reject NGGT's new NOMs Methodology⁹, which utilised a monetised risk approach¹⁰ to help address the comparability issues. As part of that decision, we expected NGGT to convert (rebase) its Original Targets to equivalent monetised risk targets so as to enable like-for-like comparison. We refer to these equivalent monetised risk targets as the "Rebased Targets". On 6 December 2018, we published our decision on a common approach to implementing the NOMs Incentive Methodology.¹¹ This decision set out the requirement for each sector to work out specific aspects of implementing this agreed methodology. 20 August 2019, NGGT submitted its final Rebased Targets to us.

⁵ NOMs are mechanisms that provide a means to monitor and assess the network asset management outcomes that network companies deliver.

⁶ Table 1: Network Replacement Outputs set the replacement priority (RP) expected to be reached by 31 March 2021. The RP is based on the of asset volumes distributed, based on their health and criticality, onto 5x4 tables. For each asset category, NGGT has stated its price control start position (2013) and its view of the price control end position (2021) for both with and without intervention scenarios.

⁷ Replacement priority targets is the expected position NGGT is targeted to meet through its intervention plan for RIIO-GT1.

⁸ These are: Entry, Exit, Compressor, Pipeline and Multijunction.

⁹ [Ofgem's decision not to reject the modified gas transmission Network Output Measures \(NOMs\) methodology](#)

¹⁰ Under this approach, risk values are represented in monetary terms as a 'common currency' to enable like-for-like comparison between assets and asset groups. Please refer to the methodology linked in footnote above for details.

¹¹ <https://www.ofgem.gov.uk/publications-and-updates/decision-network-output-measures-noms-incentive-methodology>

Consultation and responses received

On 6 March 2020, we consulted on our rebasing assessment methodology, our proposal to approve NGGT's Rebased Targets, and on our proposal to modify SpC 7E of NGGT's licence to replace the volume-based Original Targets with the monetised risk Rebased Targets. We received two responses, from NGGT and from Centrica. In the next section, we summarise the responses and our views thereon; Appendix 1 provides more detail on Centrica's response.

Summary of consultation responses and our views

NGGT's response and our views

NGGT agreed with our proposal to approve its Rebased Targets. However, it recommended that the modified licence condition should include a total value of monetised risk in Table 1, as well as wording in relation to the trading of risk across asset categories.

In our view, the licence modification proposed by NGGT is unnecessary as it would not alter the effect of the condition. We therefore have not applied the proposed modification.

Centrica's response and our views

Centrica's response contained two key points. These are summarised as follows:

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

We disagree with these points. Appendix 1 provides our rationale for this view.

Our Decision

Having considered the responses received to the statutory consultation, we have decided to confirm our consultation position to approve NGGT's submitted Rebased Targets, and to modify SpC 7E in the manner set out in the consultation. The licence modification notice is published alongside this decision letter. The modifications to SpC 7E will come into effect on 10 September 2020.

Yours sincerely,

Min Zhu

Deputy Director, Systems & Networks

15 July 2020

Appendix 1: Summary of Centrica’s submission and our response

This Appendix sets out our response to the two key points contained in Centrica’s submission.

Point 1: “The proposed Rebased Targets do not satisfy all the Rebasing Principles”

Respondent’s view

In Centrica’s view, “...the proposed Rebased Targets are based on the principle of relative risk reduction instead of the delivery of an absolute level of risk... [on which] NGGT’s Original Target was based... NGGT has not adhered to the second Rebasing Principle - the same principles shall be applied as those used in RIIO-T1 Business Plan...”.

Our response

After rebasing, NGGT’s targets will remain absolute targets.¹² In order to arrive at the absolute target value, the same approach was applied to both the Original and Rebased Targets – that is, estimating the aggregated risk associated with all network assets at the end of RIIO-T1 once the effects of asset deterioration, planned interventions, and other relevant factors have been accounted for. The rebasing exercise followed by NGGT applied the same assumptions to all of these factors, including as regards the assets and intervention within NGGT’s intervention plan, as were applied when setting the Original Targets.

We are therefore satisfied that the Rebased Targets represent the same absolute network risk position at end of RIIO-T1 as represented by NGGT’s Original Targets.

Point 2: “The assessment of NGGT’s RIIO-GT1 performance should be based on the original volumetric targets”

Respondent’s view

In Centrica’s view, “...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”, and “...without the capability to generate absolute risk targets, the necessary intrinsic relationship to the allowances NGGT received to deliver those targets is further broken...”, and “...these factors further increase the risk of windfall gains or losses, neither of which is in consumers’ interests...”.

Our response

NGGT’s NOMs-related RIIO-T1 allowances were set based on assumed workload volumes to be delivered over the eight years of the price control. While NGGT has an absolute target,

¹² ‘Absolute’ in this context refers to the total level of network risk (all network assets) remaining on its network at the end of the price control. This is as opposed to ‘relative’, which refers to the level of risk removed through asset interventions relative to the ‘no intervention’ scenario.

the intrinsic relationship to allowances NGGT received to deliver those targets remains. Our assessment of NGGT's Rebased Targets considered the work that NGGT would need to do to deliver the target, and the extent to which it could do the same work but on different assets and as a result outperform the targets (i.e. deliver a lower absolute level of network risk at the end of RIIO-T1). We refer to this as Potential to Outperform (PTO) and designed a quantitative check¹³ to derive numerical PTO scores for each asset category and at a total network level.

Comparing PTO scores between NGGT's Original Targets and Rebased Targets, we concluded that rebasing did not lead to a materially significant increase in NGGT's potential to outperform its targets. We will assess NGGT's performance at the end of RIIO-T1 and will quantify any associated incentive adjustments to RIIO-2 revenues in accordance with the NOMs Incentive Methodology.¹⁴ Any adjustments will be related to asset replacement and refurbishment work associated with over-delivery or under-delivery of targets. Therefore, in our view, there is no materially increased risk of windfall gains or losses.

¹³ Check 3: Potential to Outperform is explained in our consultation document (Appendix 3, page 31 to 33).

¹⁴ <https://www.ofgem.gov.uk/publications-and-updates/decision-network-output-measures-noms-incentive-methodology>