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Scottish Hydro Electric Transmission plc.
SP Transmission plc.
National Grid Gas Transmission plc.
Cadent Gas Limited
Northern Gas Networks Limited
Scotland Gas Networks plc.
Southern Gas Networks plc.
Wales & West Utilities Limited

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Date: 18 February 2021

Dear Stakeholders,

Consultation on issuing the Network Asset Risk Workbooks and Network Asset Risk Metric Handbook

On 3 February 2021, we¹ published our decision² on the proposed modifications to the RIIO-2 Transmission, Gas Distribution and Electricity System Operator licences. In accordance with Special Condition 3.1.7 (SpC 3.1.7)³ and Special Condition 3.1.11 (SpC 3.1.11)⁴ of the Transmission and Gas Distribution licences, we are consulting on our intention to issue the Network Asset Risk Workbooks (NARW) and Network Asset Risk Metric (NARM) Handbook. At present we are only consulting on the NARW for Transmission sectors. We will consult on the issuing of the NARW for Gas Distribution licensees at a later date.

We welcome responses on the consultation questions listed later on. The consultation will close on 18 March 2021. We intend for the NARW and the NARM Handbook to come into effect on 1 April 2021.

The draft NARM Handbook and NARW⁵ for each licensee listed above are published alongside this letter.

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/decision-proposed-modifications-riio-2-transmission-gas-distribution-and-electricity-system-operator-licences>

³ Special Condition 3.1 Part B: Network Asset Risk Workbook

⁴ Special Condition 3.1 Part C: NARM Handbook

⁵ The NARW published on Ofgem's website have been redacted for commercial sensitivity. Unredacted versions have been shared with the relevant licensees.

The NARM Handbook we are consulting on will apply to the Transmission and Gas Distribution licensees listed above. The arrangements for the Electricity Distribution licensees will be consulted in due course on as part of the RIIO-ED2 price control process.

Background: NARM in RIIO-2

The NARM has been developed to allow us to quantify the benefit to consumers of the companies' asset management activities. In RIIO-2, this will be used as the output to hold the companies accountable for their investment decisions. We set out the arrangements for Transmission and Gas Distribution companies relating to NARM in the RIIO-2 Final Determinations – NARM Annex.⁶ The companies' RIIO-2 obligations in respect of NARM are set out in Special Conditions 3.1 (Baseline Network Risk Outputs), and 9.2 (Network Asset Risk Metric methodology).⁷

The NARW

The purpose of the NARW is to set out the Baseline Network Risk Outputs (BNRO)⁸ that the licensee must deliver by the end of RIIO-2. The NARW also shows the RIIO-2 baseline funding⁹ for associated BNRO at each risk sub-category level.

There are four draft NARW (versions v3.0) published alongside this letter, one for each relevant licensee in the Transmission sector.

The NARM Handbook

On 8 December 2020, we published the RIIO-2 Final Determinations¹⁰ for Transmission and Gas Distribution network companies.

The NARM Handbook sets out the methodology for calculating relevant funding adjustments and penalties under the NARM Funding Adjustment and Penalty Mechanism (the NARM Mechanism), and provides guidance to licensees and other stakeholders on the implementation of relevant aspects of the NARM Mechanism. This includes guidance on the justification that will be required for over-delivery/under-delivery, and the treatment of non-intervention risk changes. Any relevant funding adjustments and penalties to reflect the licensee's Outturn Network Risk Outputs and incurred costs of delivery will be calculated by the Authority in accordance with the NARM Handbook.

⁶ https://www.ofgem.gov.uk/system/files/docs/2021/02/final_determinations_narm_annex_revised.pdf

⁷ https://www.ofgem.gov.uk/system/files/docs/2021/02/riio-2_licence_conditions.zip

⁸ Baseline Network Risk Output means the cumulative total, for a given risk sub-category, of Network Risk Outputs for all items allocated to "NARM Funding Category A1" in the licensee's Network Asset Risk Workbook.

⁹ Please note that the total baseline funding in NARW include on-going efficiencies and Real Price Effect (RPE).

¹⁰ <https://www.ofgem.gov.uk/publications-and-updates/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

The draft NARM Handbook (version v1.3) published alongside this letter will apply to the Transmission and Gas Distribution licensees listed above .

Consultation questions relating to the NARW

1. Do you agree that the draft NARW align with our RIIO-2 Final Determinations NARM Annex? Where you disagree, please clearly set out your reasoning and specify other considerations/factors we should take into account.

Consultation questions relating to the NARM Handbook

2. Do you agree that the draft NARM Handbook aligns with our RIIO-2 Final Determinations NARM Annex? Where you disagree, please clearly set out your reasoning and specify other considerations/factors we should take into account.
3. Do you agree with the proposed guidance in the following areas:
 - the provision of justification for over-delivery/under-delivery, and
 - non-intervention risk changes?

Where you disagree, please clearly set out your reasoning and specify other considerations/factors we should take into account.

4. Do you have any views on the appropriateness of the proposed qualifying criteria for clearly identifiable over-delivery and under-delivery, in particular on appropriate upper and lower threshold values?
5. Are there any other areas related to implementation of the NARM framework in RIIO-2 that should be covered in future versions of the NARM Handbook?

How to respond to this consultation

We are seeking your views on our draft NARW and NARM Handbook. Please send any comments to Leyun.Kong@ofgem.gov.uk by 18 March 2021. Unless stated as confidential, consultation responses will be published with our decision.

Yours sincerely,

Min Zhu

Deputy Director, Systems & Networks

18 February 2021