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Date: 3 December 2020

Dear Stakeholders,

**Decision to approve Rebased Network Replacement Outputs and to modify Special Condition 2M of the electricity transmission licences held by the licensees listed above.**

On 26 August 2020, we<sup>1</sup> published a consultation<sup>2</sup> on a proposal to approve Electricity Transmission Operators' (also referred as ETOs)<sup>3</sup> Rebased Network Replacement Outputs and a statutory consultation on modifying the contents of 'Table 1: Network Replacement Outputs' in Special Condition 2M (Specification of Network Replacement Outputs) ('SpC 2M')<sup>4</sup> of their electricity transmission licences.

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 ETOs' Rebased Network Replacement Outputs and to modify SpC 2M in the manner set out in the consultation. The licence modification notice is published alongside this letter. These licence changes will take effect from 29 January 2021.

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

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<sup>1</sup> 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.

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-proposal-approve-rebased-network-replacement-outputs-and-modify-special-condition-2m-electricity-transmission-licences-held-onshore-electricity-transmission-network-operators>

<sup>3</sup> The terms "ETO" and "licensee" are used interchangeably in this document. They refer to the onshore electricity transmission network operators (National Grid Electricity Transmission plc (NGET), Scottish Hydro Electric Transmission plc (SHET), SP Transmission plc (SPT)).

<sup>4</sup> Special Licence Condition 2M. 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)<sup>5</sup> 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 ETOs, these targets are called Network Replacement Outputs (NROs)<sup>6</sup> and are set out in SpC 2M. These NROs reflect the impact of the asset intervention workload (usually replacement or refurbishment) that ETOs have been funded to deliver in RIIO-T1, and represent replacement priority targets<sup>7</sup> to be delivered through interventions on seven NOMs lead asset categories across three voltage levels.<sup>8</sup> These NROs are based on ETOs' own methodologies for assessing the health and criticality of their network assets and the impact of its asset interventions on these parameters. We refer to these NROs as the "Original Targets".

However, because ETOs' Original Targets were volumetric based, it does not allow for robust like-for-like comparisons across different asset categories. On 7 August 2018, we published our decision to not reject the modified electricity transmission NOMs Methodology Issue 18 (the "NOMs Methodology")<sup>9</sup>, which utilised a monetised risk approach<sup>10</sup> to help address the comparability issues. As part of that decision, we expected ETOs to convert (rebase) their 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.<sup>11</sup> This decision set out the requirement for each sector to work out specific aspects of implementing this agreed methodology. The

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

<sup>6</sup> 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, ETOs have stated their price control start position (2013) and their view of the price control end position (2021) for both with and without intervention scenarios.

<sup>7</sup> Replacement priority targets is the expected position ETOs are targeted to meet through its intervention plan for RIIO-T1.

<sup>8</sup> These are: Circuit Breaker, Transformer, Reactor, Underground Cable, OHL (overhead line) Conductor, OHL fittings, and Towers (SHET and SPT only), across three voltage levels: 400KV, 275KV and 132KV..

<sup>9</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-not-reject-modified-electricity-transmission-network-output-measures-noms-methodology-issue-18>

<sup>10</sup> 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.

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

three ETOs submitted their final Rebased Targets<sup>12</sup> for Authority approval between December 2019 and July 2020.<sup>13</sup>

## **Consultation and responses received**

On 26 August 2020, we consulted on our rebasing assessment methodology, our proposal to approve ETOs' Rebased Targets, and on our proposal to modify SpC 2M of ETOs' licences to replace the volume-based Original Targets with the monetised risk Rebased Targets. We received two responses, from NGET and from SPT. In the next section, we summarise the responses and our views thereon.

## **Summary of consultation responses and our views**

### *NGET's response and our views*

NGET agreed with our minded-to position proposed in the consultation. NGET agreed that Rebased Targets have been derived in accordance with the Rebasing Principles. NGET also agreed that the monetised risk values submitted as the Rebased Targets are suitable for relative comparison and risk trading amongst the original NROs categories for the purposes of assessing each ETO's performance under the NOMs incentive mechanism at the end of RIIO-T1, and for making any consequential adjustments to its allowed revenue.

### *SPT's response and our views*

SPT agreed with our rebasing assessment methodology, our conclusion that the Rebased Targets satisfy the Rebasing Principles, and our minded-to decision to approve the Rebased Targets. However, SPT did not agree that the Rebased Targets should be simply substituted into the licence. SPT argued that the Original Targets should not be replaced within the licence without further clarity on how ETOs' performance will be assessed against the Rebased Targets. Since the the monetised risk targets are finalised for ET sector, SPT recommended that Ofgem should undertake a review of the applicability of the the NOMs Incentive Methodology, and any sector specific amendments to the methodology, which may be identified by the review, could then be undertaken at the same time as the licence modification to reflect the change to monetised risk targets.

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<sup>12</sup> During the NOMs Methodology validation process (but prior to the submission of the Rebased Targets), two errors in the equations for the system consequences and improvements in NGET's OHL conductors and fittings scoring methods in the Network Asset Risk Annex ("NARA") were identified. The Rebased Targets have corrected for these errors and implemented the improvements. On 1 December 2020, we published our decision to not reject the modified Network Asset Risk Annex ("NARA") for NOMs Methodology Issue 18: <https://www.ofgem.gov.uk/publications-and-updates/decision-not-reject-modified-network-asset-risk-annex-nara-electricity-transmission-network-output-measures-noms-methodology-issue-18>

<sup>13</sup> SPT submitted its final Rebased Targets on 6 December 2019, NGET submitted its final Rebased Targets on 3 July 2020, and SHET submitted its final Rebased Targets on 29 July 2020.

In our view, the licence modification to substitute the Rebased Targets for the Original Targets would not be affected by either how ETOs' performance will be assessed against the Rebased Targets or the review of the NOMs Incentive Methodology as recommended by SPT. We therefore disagree with SPT's point on waiting to make this licence modification.

### **Our Decision**

Having considered the responses received to the statutory consultation, we have decided to confirm our consultation position to approve ETOs' submitted Rebased Targets, and to modify SpC 2M in the manner set out in the consultation. The licence modification notice is published alongside this decision letter. The modifications to SpC 2M will come into effect on 29 January 2021.

Yours sincerely,

**Min Zhu**

**Deputy Director, Systems & Networks**

3 December 2020