Faysal Mahad
Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

15th August

Dear Faysal,

Consultation on the qualifying criteria for Clearly Identifiable Over-Delivery and Clearly Identifiable Under-Delivery, under the NARM Funding Adjustment and Penalty Mechanism

We welcome the opportunity to respond to Ofgem's consultation on the criteria for Clearly Identifiable and the NARMs Funding Adjustment and Penalty Mechanism. This response is on behalf of Scottish Hydro Electric Power Distribution plc (SHEPD) and Southern Electric Power Distribution plc (SEPD), known collectively as SSEN Distribution.

The objective of NARM is to enable the robust estimation of long-term monetised risk of condition-based asset failure for a defined range of assets. Currently this is set at 61 asset categories for the Electricity Distribution sector from the defined 104 reportable categories. The principles of NARM allow for a robust estimation of the benefits being delivered from any interventions on specific assets or groups of assets and to allow the authority to undertake an objective assessment of this delivery against a baseline set as the Network Risk Output. This enables comparative analysis of network performance of assets across each Distribution Network Operator utilising the same methodology over time. Hence it provides a mechanistic approach through NARMs to hold network companies accountable for asset management and investment decisions through the common use of the reporting framework.

Electricity Distribution differs from other sectors in that our delivery of risk reduction is considered on an aggregate basis for all NARM interventions rather than a project-by-project basis. In addition to this, DNOs are not included in the published NARM handbook used by the other sectors but adhere to the approved version of the Common Networks Asset Indices Methodology (CNAIM) published through the Energy Networks Association (ENA). This therefore means that the approach on Clearly Identifiable Over-Delivery (CIOD) and Clearly Identifiable Under-Delivery (CIUD) under the NARM mechanism may not work for DNOs should Ofgem decide that it is to be applied to all sectors as it is currently detailed in the SLC 3.1 within the Electricity Distribution licence conditions. It would not provide the flexibility needed to manage our network effectively.

Further detail of this is included in our response to the three questions Ofgem set out in its consultation. Please see our response below.

Question 1: Do you agree with our approach to assessing a suitable UCR threshold for determining clearly identifiable over and under-deliveries?

The UCR is referenced in the NARM handbook and licence conditions however it is applied in a subtly different way for the Electricity Distribution (ED) Sector. Specifically, the UCR is calculated for each licensee as a whole (similar to GD) but for Electricity Transmission the UCR is calculated for each of the seven assets or three risk levels for Gas Transmission. Electricity Distribution has 61[1] asset categories reported under the NARM mechanism. If Ofgem were theoretically to introduce the proposed approach for ED, it would create a significant amount of work in conversion to a different approach and remove the flexibility that RIIO Price control allows.

Question 2: Do you agree with our proposed UCR threshold for determining clearly identifiable over and under-deliveries?

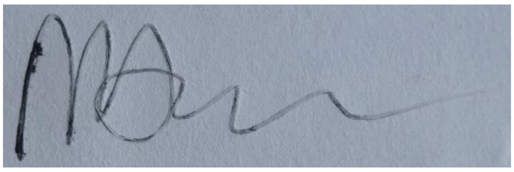
It is a particularly over complicated mechanism operating at a project level deliverable measure. It has limited flexibility for asset risk trading potentially resulting in companies not making the most efficient decisions within the price control period. Ofgem notes its proposal that network companies (ET, GD and GT) will have to provide costs on a project-by-project basis, in order for it to decide if it would meet the criteria of clearly identifiable. At a Transmission level, this amount of detail may be manageable given Transmission has several large projects. However, if applying this in Distribution, it would not be feasible to provide this amount of data given the volume of assets on our network which fall into the NARMs mechanism. If ED was required to provide detail at the project level, it would not allow us the flexibility required to ensure our network is efficient and delivering the right outcome for our customers.

Question 3: Do you agree with our positions taken on other aspects of the NARM Handbook?

The ED Sector are, by agreement with Ofgem, excluded from the NARM Handbook. The ENA's NARM Electricity Distribution Working Group (NEDWG) requested that the additional guidance and rules be incorporated within the Licence drafting for ED2 or be added to the NARM handbook in an ED specific annex, however both of these options were rejected by Ofgem. The ED sector therefore operates within its own guidance. This guidance is based on the information contained in the Closeout documentation for RIIO-ED1, cross referenced to the RIGs for RIIO-ED2, use of CNAIM and specifically licence condition 9.2 Network Asset Risk Metric methodology. As the proposed changes to the handbook do not impact SSEN Distribution, we are not against the changing governance, however, we would reiterate the points noted above. Should any of the proposals be applied to ED it will be a significant challenge and undertaking to modify the CNAIM to provide the required detail whilst adding no improved performance in our asset management capabilities. It will also restrict the risk trading capabilities across the asset classes to the detriment of the customers and our network, as well as significantly undermining the entire NARM concepts. In addition, it would likely change our approach on future investment decision making as it would become focused on delivering project specific volumes and not allow the flexibility required to manage our network efficiently by delivering the necessary investments in a timely manner.

[1] This is consistent for all DNOs in RIIO-ED2 but under review for further expansion in preparation for RIIO-ED3.

Yours sincerely



Mark Askew
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