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Threshold for justifying Clearly Identifiable Over or Under Delivery under the NARM Funding Adjustment and Penalty Mechanism

Dear Faysal,

Thank you in advance for taking the time to consider our response to the CIOD/CIUD NARM consultation.

Wales & West Utilities Limited

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

We agree with the use of UCR to adjust final spend allowances up or down based on justified over-/under-delivery. Scaling spend allowances proportional to risk removed, as compared with the baseline allowance and risk target, seems like a valid, and reasonable approach as this feels in alignment with setting, and knowing, the rules upfront. This essentially keeps the NARM process as originally intended - with companies being dealt with via the Totex Incentive Mechanism (TIM) for justified over-/under-delivery, or especially when we are within the BNRO deadband at GD2 close-out.

On the other hand, we do not agree with the proposal re. CIOD/CIUD.

Ofgem's analysis has shown a high degree of variability in UCR, both within and between asset groups, and poor correlation between money spent and risk reduced. As is made clear, this is simply a reflection of the diverse range of assets energy utilities are required to manage.

Within ET/GT risk sub-categories, we would expect a large variability in UCRs, and for GDNs, which have a single UCR at network level, UCR will likely rarely be reflective of any specific work (it's inevitably a weighting between asset groups with high/low UCRs and the volume of work being done within those asset groups).

The CIOD/CIUD mechanism seems to have good intentions, but based on incorrect assumptions.

We spent a significant amount of time and effort developing business plan workloads, based on engineering assessments, compliance with HSE rules and regulations, stakeholder requirements for safety, reliability, and value for money, and various pieces of safety legislation. These choices were articulated and approved in CBAs, Engineering Justification Papers, the NARM BPDT etc. In reality, this places us within a framework that keeps us focused on delivering what we said we would, in terms of value for money for the consumer, and providing a safe and reliable network, doing what is right for the assets. Therefore, where risk trading happens, this is to respond to changing risks and to the needs of stakeholders. This is tracked in RRP submissions, stakeholder reports, and various other documentation.

The UCR mechanism, as proposed to be used for CIOD/CIUD, is not fit for purpose for GDNs. There is a high likelihood that by default the majority of our work would be outside our network-level baseline UCR, and CIOD/CIUD would dominate the entire NARM mechanism. We believe that the original intention to allow risk trading so that GDNs can respond to daily requirements of running the network should be preserved, and that the TIM should deal with under-/over-delivery, with allowances scaled by UCR, as proposed by Ofgem under the 'automatic' mechanism within the NARM Funding Adjustment & Penalty Mechanism.

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

No; please see the response to question 1 for the reasons why.

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

We have gathered together our general thoughts, here, for your consideration.

- The overall process is ambiguous, depending on which diagram/paragraph is looked at. We believe that if a network is within the BNRO deadband then the overall process should stop there i.e. our final allowances are as per original allowances. The Totex Incentive Mechanism then deals with spend, as it does for non-NARM areas of the overall business plan.
 - We would like to see it made clearer in the NARM Handbook that the process ends if a network delivers within the BNRO deadband, including not needing to open up the highly burdensome process for CIOD/CIUD.
- CIOD/CIUD: apart from getting clarity that CIOD/CIUD only comes into play where a network is outside the BNRO deadband upfront, we would appreciate a clearer statement on the process whereby the GDNs are required to propose CIOD/CIUD elements. Could Ofgem please clarify that it is up to the GDN's discretion to evaluate if any work is proposed to Ofgem for consideration under the CIOD/CIUD mechanism?
- An example given in the documentation for CIOD seems to show that CIOD work is funded at cost. This would mean that all work evaluated as CIOD is held cost-neutral. This contradicts the Totex Incentive Mechanism, where savings or overspend are split with the consumer. This would create a situation whereby networks are encouraged to find ways to deliver work at more efficient costs, but when the networks are too successful in doing so, they make no returns on the work done as it then becomes CIOD. This whole mechanism would go against claimed typical returns declared by Ofgem for the price control e.g. during the investor calls held by Ofgem. As an example, if a network manages to negotiate contractor costs down for a set of work, and this falls into the CIOD mechanism, the network is penalised compared to not negotiating at all, based on a 5% threshold around UCR that Ofgem proposes.

- Close-out Report
 - It is a bit unclear how the close-out report matches the overall process.
 - Where a network is within the BNRO deadband, we would expect the close-out reporting requirements to be streamlined and more concise i.e. a summary of spend, risk removed, and some key points, per NARM asset group.
 - Could Ofgem please confirm that this is the intention?
 - Where there is an under-/over-delivery of risk, we understand that the close-out report would likely require a greater level of explanation, as part of the justification process. However, it is very unclear what those reporting requirements would look like and in particular at what level of aggregation/disaggregation would this be required?
 - GD has a target at network level. When talking about concepts like CIOD/CIUD, and the close-out report, what is meant by a project? Is this all work done within a NARM asset category?

Thanks again for the opportunity to comment on the proposals and I hope our feedback is constructive and useful.

Yours Sincerely

Ian Dunstan

Asset Strategy Manager
Wales & West Utilities