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Consultation on the Network Output Measures (NOMs) Incentive Methodology

Dear Paul,

We are pleased to be invited to respond to this consultation. Citizens Advice has statutory responsibilities to represent the interests of energy consumers in Great Britain. This document is entirely non-confidential and may be published on your website. If you would like to discuss any matter raised in more detail please do not hesitate to get in contact.

We appreciate you taking the time for to discuss this consultation with us. You asked us to comment on three specific areas of this consultation. With that in mind we will not directly answer the questions outlined in the consultation document, but we will address the three decision points you raised with us.

Broadly, we agree with the proposed methodology.

Relevant Risk Changes

We agree that network companies should not benefit from windfall gains where assets are in a better condition than originally assessed at the beginning of the price control. The change in anticipated condition occur for a number of reasons - lower than expected use, better condition monitoring or inadequate initial assessment of the condition of the asset. Therefore it seems reasonable that any gains in this area count towards the risk reduction target.

Associated Costs

We agree with Ofgem's position on associated costs. Under delivery should be calculated at the allowance rates. It is appropriate for the network companies to justify how any associated costs are efficient to Ofgem prior to Ofgem's two-stage assessment.

Deadband

We agree with Ofgem's position to adopt a deadband around the risk target, which appears to be a sensible approach. For the transmission company deadband, we

are keen to ensure that this is of an appropriate scale and would welcome input when baselining is complete.

Further points

It would be helpful to have more detail on the intended methodology for justification assessments for use in the event that a Licensee is deemed as having over- or under-delivered (as per Stage 6 of the incentive assessment process). This process is crucial to the NOMs approach and will form an important part of the reputational legitimacy of the proposals. In line with this, we would like to see Ofgem set out the possible risks associated with this stage of the overall process, as well as the extent to which this stage will be public for third-party scrutiny.

We are encouraged by Ofgem's clear intent to correct some of the oversights present in the current price control, by ensuring that the RIIO2 framework contains failsafe mechanisms that allow for clawbacks should company outperformance become excessive. In our response to the RIIO2 framework consultation we said that we thought these mechanisms should only be used in exceptional circumstances rather than for business as usual. Correspondingly, we strongly urge a similar clawback mechanism to be included in the NOMs methodology, which we expect to be only used under exceptional circumstances. A risk to consumer costs (due to incorrect justification assessments) exists if significant information cannot be retrospectively used to correct for such error. Reliance on the methodology itself may prove insufficient in predicting such cases, and this risk can be straightforwardly mitigated through the inclusion of a suitable clawback mechanism in the process.

We would like to see clarification on how the benefits of justified under-delivery will be shared with consumers, in relation to the sharing factors used in the wider RIIO framework. It would be good to clarify under what conditions under-delivery will be attributed to impacts outside the control of companies, and how allowances will be treated in such cases. Further, we would like to see clarification on why no adjustments are planned for ED companies who are unjustified in their over-delivery, unlike the other parts of the sector. It would be useful to have the reasoning clarified for setting a reward of 2.5% for justified over-delivery, and what other rates or methods were considered.

Furthermore, we would expect the NOMs methodology in the RIIO-2 period to ensure that:

- initial asset condition data is strengthened to minimise risk changes over time; and

- transparency of associated costs is increased to better inform qualified or non-qualified costs.

I trust that this response is clear, but would be happy to discuss any matter raised within it in more depth if that would be helpful.

Yours sincerely

Stew Horne

Principal Policy Manager, Energy Regulation