

Jonathan Booth  
Head of Asset Management  
Electricity North West Limited  
Hartington Road  
Preston PR1 8AF.

Regulatory Affairs  
Ground Floor, Lakeside West  
30 The Causeway  
Staines  
Middlesex  
TW18 3BY

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Dear Jonathan,

**Common Network Asset Indices Methodology Proposed Modifications – Standard Licence Condition 51 Part I Consultation – supplementary information**

Thank you for the opportunity to respond to the above consultation. This is a non-confidential response on behalf of the Centrica Group, excluding Centrica Storage.

Thank you for publishing the *Supplementary Information*, as an addendum to the February 2017 Standard Licence Condition 51 Part I Consultation. The additional information provided has improved our understanding of the proposals. We remain supportive of the broad intent of the proposed changes to the Common Network Asset Indices Methodology (CNAIM) because the rationale for change seems sensible. However, we also remain concerned whether the proposed changes are appropriate for achieving that broad intent.

The issues relating to ‘averaging’ and ‘outliers’ as discussed in the February Consultation and the *Supplementary Information* suggest the current version of the CNAIM can lead to the systematic over- or under-estimation of risk in individual licence areas, relative to actual conditions. In some instances, the CNAIM represents material departures from some licensees’ methodologies for quantifying risk and from asset parameters.

While the proposed changes may be a reasonable reflection of risk at a sector level, these systematic distortions have not been mitigated at the individual DNO level. These artificial, systematic distortions could compromise the capability of the CNAIM as a tool for measuring actual delivery by each DNO. We recommend:

- **The use of licensee-specific parameters within the CNAIM should be investigated instead of measures of central tendency.**
- **The RIIO-ED1 price control period should be used to make improvements to the CNAIM which can then be used for RIIO-ED2.**

**The use of licensee-specific parameters within the CNAIM should be investigated instead of measures of central tendency:**

In our response to the February consultation, we said the approach to identifying ‘outliers’, or whether it is even appropriate to exclude ‘outliers’ would need to be explained to allow stakeholders to assess the suitability of the proposed values of  $k$ . From the Supplementary

Information provided it would appear that the use of medians, and the exclusion of ‘outliers’, is justified on the basis that the answer would not be sensible otherwise. However, those data points may well fully reflect genuine asset properties for those specific licence areas and the proposed values of  $k$  will, indeed, apply to those assets in those areas. It is not obvious why valid data would need to be excluded from a robust methodology. The need to exclude data in this instance is more likely to indicate the approach being taken is not appropriate to apply across all licence areas.

We are concerned that the approach to ‘averaging’ and ‘outliers’ introduces systematic over- or under-estimation of risk, relative to each licensee’s individual circumstances, across the sector. These systematic distortions could result in sub-optimal asset management and operational strategies being adopted and, by extension, result in sub-optimal outcomes for consumers. We recommend the use of licensee-specific parameters in the CNAIM should be investigated in order to better reflect each licensee’s individual circumstances and to better facilitate the assessment of the genuine impact of expenditure on network health. We note there is precedent for licensee-specific consideration within a common outputs methodology, as described in a recent Direction to the electricity transmission operators<sup>1</sup>.

### **The RIIO-ED1 price control period should be used to make improvements to the CNAIM which can then be used for RIIO-ED2:**

The issues raised in the *Supplementary Information* reinforce our view that the assessment of performance on any basis other than which allowances were provided is not in consumers’ interests. We continue to believe the RIIO-ED1 period should be used to thoroughly test, calibrate and validate the CNAIM. The acknowledgment of the lack of a deeper understanding of the impact of the CNAIM on intervention requirements<sup>2</sup> is further evidence that more experience of the CNAIM is needed before it should be used to assess performance. The RIIO-ED1 period should also be used to expand the CNAIM to include all asset types, as per Ofgem’s stated intent of the methodology<sup>3</sup>.

We hope you find these comments helpful. Please do not hesitate to contact me if you have any questions.

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<sup>1</sup> Direction under paragraph 2L.13 of Special Condition 2L (Methodology for Network Output Measures) of the electricity transmission licence (<https://www.ofgem.gov.uk/publications-and-updates/decision-direct-modifications-electricity-transmission-network-output-measures-methodology>)

<sup>2</sup> As discussed in a DNO’s commentary that supported its submission for proposed risk reduction targets to Ofgem. The submissions may be found at: <https://www.ofgem.gov.uk/publications-and-updates/network-asset-secondary-deliverables-rebasing-consultation>

<sup>3</sup> Notice of proposal to direct modifications to the Common Network Asset Indices Methodology under Part C of SLC 51, page 2 (<https://www.ofgem.gov.uk/publications-and-updates/consultation-distribution-network-operators-dnos-common-network-asset-indices-methodology>)

Yours sincerely,

Andy Manning

Director - Network Regulation, Forecasting and Settlements