

To electricity distribution  
companies and other interested  
parties

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Date: 5 May 2017

## **Decision to approve the Rebased Network Asset Secondary Deliverables Targets submitted by Distribution Network Operators**

In line with Electricity Distribution Licence (the 'Licence') requirements<sup>1</sup>, each of the electricity distribution network operators (DNOs) submitted their Rebased Network Asset Secondary Deliverables (NASD) Targets for approval by Ofgem. Following our public consultation<sup>2</sup>, we have decided to approve all of these submissions. This letter explains our reasons for these approvals.

### **1. Background**

As part of the RII0-ED1 price control review, each DNO provided forecasts of their asset health and criticality positions 'with intervention' and 'without intervention'. We used these to set out the improvements in asset health and criticality required of each DNO's asset base during the price control. This is referred to as the Network Asset Secondary Deliverables (NASD) Target Risk Delta.

Each DNO forecast was based on their own specific assessment methodology. It was recognised that it would be beneficial for the DNOs to report performance using a common framework to enable us to monitor companies' performance on a consistent basis and ensure long-term delivery and value for money. Therefore, the price control settlement included a Licence condition<sup>3</sup> to mandate the development of a common methodology for asset health, criticality and monetised risk. The DNOs have worked together to develop the Common Network Asset Indices Methodology (CNAIM), which was initially approved by the Authority on 1 February 2016<sup>4</sup>. Our approval letter directed the licensees to rebase their Network Asset Secondary Deliverables using the CNAIM<sup>5</sup>.

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<sup>1</sup> CRC 5D.17 of the Electricity Distribution Licence

<sup>2</sup> <https://www.ofgem.gov.uk/publications-and-updates/network-asset-secondary-deliverables-rebasing-consultation>

<sup>3</sup> SLC 51

<sup>4</sup> <https://www.ofgem.gov.uk/publications-and-updates/decision-dno-common-network-asset-indices-methodology>

<sup>5</sup> During the implementation of the approved CNAIM draft version V4, the DNOs made a number of amendments to correct errors or omissions in the methodology and we approved the CNAIM v1.0 pursuant to SLC 51.27 on 21 October 2016 - see <https://www.ofgem.gov.uk/publications-and-updates/decision-distribution-network-operators-common-network-asset-indices-methodology>

## 2. NASD Rebasing requirements

During the last quarter of 2016, the Reliability Working Group was used as a forum to discuss how the NASD Rebasing would be undertaken<sup>6</sup>. Part C of CRC 5D of the Licence sets out the requirements for rebasing and modification of the NAW, with CRC 5D.17 and 5D.18 being particularly relevant:

- CRC 5D.17 states that the licensees:

'must develop and submit for approval to the Authority a revised set of Network Asset Secondary Deliverables ("Rebased Network Asset Secondary Deliverables") in accordance with the Common Network Asset Indices Methodology, which are trued up to take account of actual data up to and including 31 March 2015.'

- CRC 5D.18 states that:

'The Rebased Network Asset Secondary Deliverables must:

- a) be consistent with the Common Network Asset Indices Methodology;
- b) remain equally as challenging as those set out in the Network Assets Workbook that was applicable at 1 April 2015, as calculated using the values for Average Probability of Asset Failure and Average Consequence of Asset Failure applied at that time adjusted for any modification to the Regulatory Instructions and Guidance (RIGs) or Common Network Asset Indices Methodology;
- c) be in the same format as the Network Assets Workbook; and
- d) be based on actual rather than forecast data up to and including 31 March 2015.'

Ofgem also published the NASD Rebasing Requirements and Assessment Methodology<sup>7</sup> in order to facilitate the DNOs' submissions and our assessment.

For the rebasing of the NASD Targets the DNOs were required to resubmit the Network Asset Workbook and Secondary Deliverables Monetised risk files. These files set out the improvements in asset health and criticality and calculate the NASD Target Risk Delta.

## 3. Ofgem Consultation

The DNOs submitted their rebased NASD Targets on 30 December 2016 and we consulted with our minded-to decision to approve the submissions on 3 March 2017.

We received responses to our consultation from all six DNOs and British Gas; these are all published alongside this letter. Below, we have summarised the responses to the three questions, to which interested parties were invited to respond.

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<sup>6</sup> <https://www.ofgem.gov.uk/publications-and-updates/reliability-working-group>

<sup>7</sup> <https://www.ofgem.gov.uk/publications-and-updates/network-asset-secondary-deliverables-rebasing-requirements-and-assessment-methodology>

All of the responses except those from WPD and British Gas were supportive of our minded to position to approve the rebased NASD Targets. WPD did not give a view for any of the consultation questions but focused on future rebasing exercises. British Gas did not specifically respond to any of the consultation questions, but highlighted that it does not agree that the NASD Targets should be rebased during the current RIIO-ED1 price control.

Ofgem’s consultation questions

- 1. Do you agree that the Network Asset Secondary Deliverables Rebasing Requirements and Assessment Methodology document provides a suitable basis for the submission of the NASD rebasing and subsequent assessment methodology?**

ENWL, NPg, SPEN, SSEN and UKPN, all agreed that the NASD Rebasing Requirements and Assessment Methodology document provides a suitable basis for the submission of the NASD rebasing and subsequent assessment methodology.

We also note that ENWL suggests that the equally as challenging tests could be used as a precedent when considering RIIO-ED1 NOMs closeout.

- 2. Do you believe that the equally as challenging tests are comprehensive, appropriate and will result in a target risk delta that is equally as challenging? Where you disagree please clearly set out your reasoning and suggest how it could be improved to fulfil that objective.**

ENWL, NPg, SPEN, SSEN and UKPN, all agreed that the equally as challenging tests are comprehensive, appropriate and will result in a target risk delta that is equally as challenging.

- 3. Do you agree with our intention to approve each of the DNO submissions and our view on each of the assessment criteria explained in Chapter 2? Where you disagree please clearly set out your reasoning and if possible suggest an alternative solution.**

ENWL, NPg, SPEN, SSEN and UKPN, all agreed with our intention to approve each of the DNO submissions and with our view on each of the assessment criteria explained in Chapter 2.

Other issues raised

Respondents provided views on a number of specific points, which we have summarised in Table 1 below.

**Table 1 – Consultation representations and Ofgem’s response.**

<b>Consultation Response</b>	<b>Ofgem Response</b>
<p><b>Originally agreed NASD Targets not as equally as challenging across DNOs</b></p> <p>ENWL: Applying Test 1 to the original NAW reveals that targets ranged from 39% to 89% of the maximum theoretical reduction based on the allowed volumes. The rebasing exercise reveals a similar range from 44% to 95%. This does not result in a level playing field for companies seeking to outperform the target, and this needs to be considered</p>	<p>The scope of the rebasing assessment was to translate the agreed target risk deltas for RIIO-ED1 from the DNO’s own methodologies to the CNAIM. It was not to determine whether the targets are equally as challenging across DNOs. The results of the rebasing exercise have provided us with additional confidence that the asset risk values derived using CNAIM are comparable</p>

<p>when assessing company delivery within period against unequally stretching targets, as well as part of future RIIO-ED2 benchmarking and cost assessment discussions.</p>	<p>across DNOs. Having a CNAIM that provides comparable asset risk values gives us the opportunity to better consider the relative demands embedded in any targets we might set in the next price control.</p>
<p><b>Part 2.7 of consultation potentially misleading</b></p> <p>ENWL: introduction of CNAIM has caused a revision in risk scores for DNOs compared to legacy approaches; however, the underlying risk of the network is unchanged.</p>	<p>We agree with ENWL and this sentence should have read "It shows a significant reduction in the risk score for WPD and SSEN and increases for ENWL, NPg and SPEN."</p>
<p><b>Additional scrutiny</b></p> <p>ENWL: keen to participate in any discussions on applying additional scrutiny to understand how they may feed into both the RIIO-ED1 NOMs closeout methodology and RIIO-ED2 approach.</p> <p>NPg: Since no principles have yet been established for future performance assessments, it would be helpful to understand what this additional scrutiny may consist of and its application within the overall performance assessment, particularly given that Ofgem is expecting DNOs to trade the risk across asset categories.</p> <p>The basis on which this requirement for additional scrutiny has been established is not transparent as it is not captured within the Rebasing Methodology itself. It is important to understand if, and how, Ofgem has identified and imposed such a requirement and specifically whether any assessment of proportionality has been undertaken.</p> <p>There seems to be an inconsistency and disproportionality in how the additional scrutiny is to be applied. We would suggest that this could be resolved by establishing the principles and documenting said principles within the Rebasing Methodology.</p> <p>BG: It is unclear how additional scrutiny for particular asset categories in future performance assessments could alleviate our concerns if the rebased targets were approved and the associated licence modifications made.</p>	<p>In some cases, where DNOs have failed tests we have indicated that we will apply additional scrutiny during the performance assessment. All of these instances are where the DNO has stated that the failure is due to named schemes as we believe it is important to understand where interventions are driven by factors that the CNAIM is not able to capture. We consider it important to understand the principles that were applied in the business plan (e.g. wayleaves constraints) and whether there were changes during the price control. We have not provided any detail on this process as this will require development along with the RIIO-ED1 NOMs closeout methodology.</p>

<p><b>Further Rebasing Exercise</b></p> <p>SSEN: Ongoing data improvements made by DNOs do not lead to a modification of the CNAIM and therefore SSEN's view is that such improvements should simply be captured through "Material Change", which would be consistent with how any other DNO would manage data improvement exercises during the price control. The rebasing of the NAW should only be undertaken in extreme circumstances as it creates uncertainty with regard to the required improvements in asset health and criticality which a DNO must undertake during the price control. The significance of the material changes and its subsequent impact should be the trigger as to whether another rebasing exercise is required, rather than placing a requirement on a specific DNO.</p>	<p>Based on SSEN's rebasing submission we believe that there is the potential for significant material change and therefore we have required SSEN to carry out another rebasing unless it can demonstrate that it is not required. SSEN have suggested that these data improvements could be captured through "Material Change". However, it is our view that comparative analysis of material change would be difficult to assess given SSEN's volumes of material change is likely to be significantly more than the other DNO's. Additionally, grouping all the data improvement into material change will make it difficult to unpick and understand what is driving the material change and it is likely that assets will move up and down the asset index grades with little understanding as to the reason for the movements. Finally, we believe that there would also be significant issues with defining a level of material change that would require a rebasing. We intend to continue to work with SSEN on a bilateral basis to determine the impact of the material changes that are observed and whether the rebasing is necessary.</p>
<p><b>Fluid Filled Cables</b></p> <p>SSEN: A proposal to use the Reliability Mechanism for SSEN's policy on this asset category to bring it into line with the other DNOs use of CNAIM, or to raise a proposed change to the CNAIM. Currently, our preferred approach would be to utilise the Reliability Mechanism in RIIO-ED1 to explain SSEN's methodology to allow it to align with CNAIM and then propose further changes for RIIO-ED2 mechanisms. This would prevent the need to raise a change to the CNAIM, which if accepted, would subject all other DNOs to another rebasing exercise.</p>	<p>We note that SSEN accepts the challenge to propose changes to the CNAIM for fluid filled cables for RIIO-ED2. Our view is that changes should be proposed for the next version of the CNAIM and we discuss the timing of these future changes as part of the "Licence requirement for automatic rebasing exercise" representation below. We don't propose that SSEN make any changes to its rebasing submission at this time.</p>
<p><b>Fixed Targets for RIIO-ED1</b></p> <p>WPD: The rebasing process is very data intensive and takes a number of months to complete for the full range of asset categories affected. Having established rebased targets using the CNAIM, we urge Ofgem to fix the targets for the remainder of RIIO-ED1. This will give greater certainty for DNOs, Ofgem and interested stakeholders. It will allow DNOs to establish intervention prioritisation rules in order to deliver the</p>	<p>As set out in this decision letter, the NASD Targets are now approved. These will form the basis on which the DNOs will report and be assessed for the RIIO-ED1 period. As with other mechanisms where targets are set in advance, the intention is always to fix the targets. However, this cannot preclude the need to modify targets should information change and the need for changes arise.</p>

<p>outputs in the most efficient way and allow Ofgem to track delivery progress against the fixed targets.</p> <p>UKPN: It is important that the RIIO-ED1 output targets are agreed now, as we begin the 3<sup>rd</sup> year of the RIIO-Ed1 price control. This will allow the DNOs to plan and manage delivery of their outputs over the remainder of the price control period, and provide a stable framework for Ofgem and our stakeholders to monitor progress. Any further developments to improve cross sector consistency must avoid further changes to the output targets for the RIIO-ED1.</p>	
<p><b>Licence requirement for automatic rebasing exercise</b></p> <p>WPD: Where improvements to CNAIM are identified during the remainder of RIIO-ED1, this may lead Ofgem to seek changes to the methodology (licence condition CRC 5D). Any additional rebasing exercises will revise delivery targets and make the tracking of progress more complicated and uncertain. The licence obligation should be revised such that the requirement for automatic rebasing following any approved amendments to the CNAIM is removed.</p> <p>If any improvements are identified, revisions to the methodology should be factored into the processes to be used for the next price control (RIIO-ED2). It would be beneficial for both Ofgem and DNOs to have any changes for RIIO-ED2 finalised ahead of DNOs submitting business plans and associated data. This would reduce the need for future rebasing exercises after conclusion of the RIIO-ED2 price control.</p>	<p>Our view is that unless any significant issues or new information arises, then the development of the CNAIM can continue during the RIIO-ED1 period with a view to implementing these changes for RIIO-ED2 rather than as they arise during RIIO-ED1. As our previous response indicates, this does not preclude the need to modify the CNAIM should the need for changes arise. This allows the DNOs to continue to develop a “working version” of the CNAIM during the RIIO-ED1 period.</p>
<p><b>NASD Targets should not be rebased</b></p> <p>British Gas: The targets for the NASD, upon which the RIIO-ED1 settlement is based, should not be rebased during the current price control and DNOs should report on a dual basis through RIIO-ED1. The rebasing of targets during RIIO-ED1 for assessing performance appears contrary to the RIIO framework. The CNAIM is, in some instances, a significantly different approach to</p>	<p>British Gas raised this concern during the original consultation on the Common Methodology but we felt that the assessment of the DNO performance against the NASD targets would be more transparent and robust using the Common Methodology. Our decision on 23 October 2015<sup>8</sup> sets out our response and we are still of the same view.</p>

<sup>8</sup> <https://www.ofgem.gov.uk/publications-and-updates/dno-common-network-asset-indices-methodology>

<p>quantifying network risk compared to the individual methodologies used to generate existing agreed targets. The assessment of performance on any basis other than that on which allowances were provided may not be in consumers' interests. There is a risk that rebasing will weaken the targets, whereas it is not clear what the benefit of rebasing is.</p>	
<p><b>Improvements to the CNAIM</b></p> <p>British Gas: The RIIO-ED1 price control should be used to make improvements to the CNAIM which can then be used for RIIO-ED2.</p> <p>There seems to be insufficient experience of using the CNAIM to quantify network risk. The CNAIM should be thoroughly calibrated, tested and validated prior to implementation in RIIO-ED2 for the purposes of assessing performance. It will encourage the DNOs to bring forward improvements without any concerns about the potential impact of further rebasing of RIIO-ED1 targets.</p>	<p>We set out our reasoning for implementing the CNAIM and carrying out the rebasing during RIIO-ED1 in our response to the "NASD Targets should not be rebased" representation. Additionally, our response to "Fixed Targets for RIIO-ED1" covers the concerns about making further improvements to the CNAIM during this price control. We will continue to work with the DNOs during the RIIO-ED1 control period to develop the CNAIM further and ensure that the methodology is as robust as possible for RIIO-ED2.</p>
<p><b>Divergences from the Methodology</b></p> <p>British Gas: some issues encountered by DNOs when preparing submissions; divergences from the NASD Rebasing Requirements and Assessment Methodology; and divergences from the CNAIM. These reinforce our view that rebased targets should not be used to measure performance during RIIO-ED1. We would expect DNOs to adjust delivery programmes whenever better quality data become available. However, it is not necessary to rebase existing agreed targets to take account of better quality data. The existing RIIO-ED1 framework allows DNOs the flexibility to adjust delivery programmes by way of the Material Changes mechanism. The number of workarounds used by the DNOs to prepare submissions and divergences from the CNAIM suggest it is premature to use rebased targets to measure performance during RIIO-ED1.</p>	<p>During our consultation we identified, as part of our assessment, instances where DNO submissions diverged from the NASD Rebasing Requirements and Assessment Methodology. We set out the impact and gave our view that these divergences are not material. Additionally, we believe that the implementation and the rebasing tests ensure that the targets are more transparent and not subject to the DNOs own interpretation of asset health. This will ensure that the performance assessment is carried out effectively.</p>
<p><b>Unapproved CNAIM modifications</b></p> <p>British Gas: We note submissions were prepared according to a methodology which has not yet been formally approved and for which the DNOs are currently</p>	<p>As explained in the consultation, the changes to the CNAIM does not affect our view of whether the rebased targets are equally as challenging. If the changes to the CNAIM</p>

seeking stakeholders' views on its appropriateness.	were not approved, then the DNOs would be required to update their NAWs.
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#### **4. Our decision**

We have considered the consultation responses above and have decided to approve the rebased Network Asset Secondary Deliverables Targets pursuant to CRC 5D.25. The targets are set out in the Network Asset Workbook and Secondary Deliverables Monetised Risk file which are published alongside this letter.

Yours faithfully,

**Min Zhu**  
**Associate Partner Networks Analysis**