

**RESPONSE FROM CE ELECTRIC UK FUNDING COMPANY, NORTHERN ELECTRIC DISTRIBUTION LTD AND YORKSHIRE ELECTRICITY DISTRIBUTION PLC TO THE OFGEM CONSULTATION 'REQUESTS FOR RELIEF FROM THE CONSEQUENCES OF OVER-RECOVERY ON THE BASIS THAT ACCELERATED GROSS VOLUME CORRECTIONS MAY HAVE DISTORTED LOSSES REPORTING'**

**31 August 2010**

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## INTRODUCTION

1. CE Electric UK Funding Company (CE) is the UK parent company of Northern Electric Distribution Ltd (NEDL) and Yorkshire Electricity Distribution plc (YEDL). NEDL and YEDL are each the holder of an electricity distribution licence (the licence). This note sets out the response of CE, NEDL and YEDL to the Ofgem consultation headed 'Requests for relief from the consequences of over-recovery on the basis that accelerated gross volume corrections may have distorted losses reporting' issued on 20 July 2010 (the *Consultation*).
2. Around March 2010 we became aware of significant and unusual activity on the part of some electricity suppliers with respect to the data relating to Settlement Days under the trading arrangements operated in accordance with the Balancing and Settlement Code (BSC).
3. The activity was significant enough to have a material impact on supplier volume allocations that are presently being treated under Settlements as occurring in the Regulatory Year 2009/10. We have made extensive follow-up investigations and have discovered a great deal about the extent to which suppliers are able to make changes to settlement data, particularly in relation to the period that we previously thought had past the point where adjustments could be made. Although our understanding of the supplier management of settlement has improved, we have been unable to reach a complete understanding of the reasons for the data changes that are being reflected in the changes to supplier volume allocations, but it is beyond any doubt that there has been significant use of facilities within the settlement process, particularly, but not exclusively, the gross volume correction (GVC) facility, which has the effect that data from settlement periods that are closed (or crystallised, to use the terminology employed by Elexon) is attributed to periods that are still open.
4. Neither Ofgem nor Elexon has complete visibility of the extent to which this facility is being used by suppliers and we have reached no conclusions at this stage as to whether the GVC facility is being used correctly or incorrectly with regard to the rules of the BSC. However, our view is that the correctness, or otherwise, of the application of facilities such as GVC under the BSC it is not directly relevant to whether or not there is a need to review our reported losses calculation. Although our own investigations have yielded some very useful information that we shall share with Ofgem, there is a

limit to the level of the detail that we are able to obtain from suppliers. We urge Ofgem to gather the necessary data from suppliers and Elexon that may enable it to form a judgement on these matters. The effective operation of the losses incentive in DPCR5 may well require further changes to the rules governing supplier volume allocations and we believe that there may be a case to change the governance arrangements surrounding some aspects of Settlements.

5. However, these important issues are not the immediate concern of this particular Ofgem consultation. In the *Consultation* Ofgem has, very helpfully in our view, sought to establish clarity about how it proposes to deal with some immediate (and unintended) consequences of supplier activity with respect to supplier volume allocations. If these issues had not been addressed this would leave distributors with little choice but to make potentially hasty and unsustainable changes to tariffs to mitigate the impact of the large and unexpected over-recoveries. We shall direct the majority of our attention to these immediate concerns in this response and we fully expect to continue the dialogue with Ofgem on the wider implications for the close-out of the DPCR4 losses incentive and, more significantly, for the DPCR5 losses incentive.

#### **OFGEM'S 'MINDED-TO' POSITION**

6. In the *Consultation* Ofgem sets out the position that it is minded to take with respect to:
  - the application of the penalty interest rate for over-recoveries; and
  - the setting of use of system charges for the regulatory year 2010/11.
7. The *Consultation* does not give any 'minded-to' position on the substantive question of the implications for the losses incentive scheme and the DPCR4 revenue driver other than to say that, if it proved appropriate for a distributor to restate information on units distributed in 2009/10, the growth driver adjustment would also be updated and this would flow through into revenue allowances.
8. The *Consultation* invited comments on the 'minded-to' positions outlined by Ofgem and on the substantive issues relating to the use of Settlements information for the losses incentive applied to distribution network operators (DNOs).

9. Our views on the ‘minded-to’ position are set out below. As far as the more substantive issue is concerned we have been looking at a number of possible ways that the problem of the unreliability of the losses data for 2009/10 could be dealt with for the purposes of the close-out of the DPCR4 losses incentive and for the setting of the targets and the measurement of performance against those targets in the DPCR5 period. We would like to explore these issues in further discussions with Ofgem in the coming weeks.

#### **THE MATERIALITY OF THE ISSUES RAISED IN RELATION TO THE CALCULATION OF THE DISTRIBUTION LOSSES OF NEDL AND YEDL**

10. Throughout the DPCR4 period NEDL and YEDL used the unadjusted output from Settlements to determine ‘adjusted units distributed’ ( $AUD_t$ ) for the purposes of the calculation that has to be made in accordance with special condition C1 – *Calculation of charge restriction adjustments arising from the distribution losses incentive scheme* (the Condition) of the licence. Under that method, any reconciliations that flow through settlements *during* a given regulatory year are treated for the purposes of establishing the adjusted units distributed as having flowed in the year in which the settlement data entry is created. In calculating  $AUD_t$  we have not ‘reallocated’ those units of energy (whether positive or negative) back to the point in time at which Settlements is suggesting that the flow took place. The basis of that method was that:

- there was a limited period in which adjustments could be made (i.e. the settlement period); and
- relatively consistent volumes of reconciled data in each year would be a reasonable proxy for the difference between what had been reported at initial settlement runs and the final answer that would flow through Settlements by the end of the settlement period.

11. One of the main reasons for adopting that method was that it would be helpful for customers and suppliers if we were to declare a fixed outcome to the calculation in each year at the time of the revenue return, rather than to make a guess as to how the information would be amended by future settlement runs that would then require restatements as subsequent Settlement data was received after the point at which we declared our result for a given year. At the time that the method was set, it was

generally expected that the volatility in settlement reconciliation initially seen after market start-up was declining. This expectation was explicitly shared by Ofgem.

12. The observed changes in some suppliers' behaviour since June 2009 have the effect that, unless NEDL and YEDL make a change to the basis on which they calculate AUD, electrical losses will be imputed to the relevant year 2009/10 that:
  - certainly did not occur in that year;
  - may not have occurred in the DPCR4 period; or
  - may not have occurred at all.
  
13. As part of our investigations into these wider issues, we have also discovered that the algorithms that the settlement system uses are susceptible to distortion if suppliers use the facility that is legitimately open to them to estimate consumption, without then securing a proper meter reading subsequently. The result can be that Settlements creates *negative* estimated annual consumption (EAC) values within the settlements process that may have arisen as a result of the supplier behaviour. A negative EAC suggests that a domestic property is *generating* units rather than consuming them. We have recently carried out a sampling exercise on 39% of the MPAN data that relates to our networks. We discovered a surprisingly large number of negative EACs in the data (which, it is worth noting, is data that has only very recently been made available to distributors and is required to be provided on a once-per-quarter basis. We do not have continuous access to the consumption data at MPAN level). We have extrapolated our findings across the entire non-half hourly metered population, from which we estimate that there are 59GWh of negative EACs across NEDL and YEDL. On an annual basis the negative EACs create losses of 59GWh with an adverse losses incentive effect of £3.59m in addition to the consequences of the change in supplier behaviour described above. Since we have only a snapshot of the data we do not have any way of assessing the extent to which the current situation has prevailed throughout the DPCR4 period. If it has been a consistent feature of suppliers' behaviour over the DPCR4 period we will have suffered significant adverse impacts during the earlier years of the DPCR4 period. If it has not been a consistent behaviour on the part of suppliers we are poised to be damaged by both the immediate effect under the DPCR4 losses incentive and by the effect of the DPCR4 losses roller as it treats these implausible data entries as a

component of deteriorating losses performance. We note that Elexon has recently introduced a rule that will stop the algorithm producing new negative values, but the timing of that change will not recover any of the damage done to date.

14. Taking all of these data issues together, CE believes that the resulting impact of these changes is material given the rapid movement in over-recovery seen between publication of final charges and the submission of our standard licence condition 47 audited price control return as detailed later in this paper. CE believes that the majority of this movement is attributable to suppliers' actions.
15. In its consideration of the issues raised by these changes to supplier volume allocations Ofgem may be guided by the materiality of the issue. The scale of the distortion is such that, unless a change to the method of calculation is agreed by the Authority or some other action is taken, NEDL and YEDL would not only be regarded as having over-recovered under their 2009/10 allowance by £11.891m and £22.895m respectively, but they would also incur the penalty interest rate that applies to over-recoveries in excess of 3% of Combined Allowed Distribution Revenue. Moreover, the scale of the effect of suppliers' behaviour is sufficient to cause NEDL and YEDL to breach the threshold set out in paragraph 14.3 of CRC14 – *Distribution Charges: supplementary restrictions* that applies where over-recoveries exceed 5% of Combined Allowed Distribution Revenue. Bearing in mind that this is the regulatory long-stop that is designed to enable the Authority to take control of the licensee's tariff-setting when the licensee has over-recovered beyond any reasonable extent under normal circumstances, it is clear that the consequence of this supplier activity is of an order that the licence assumes would justify serious regulatory intervention.
16. It occurs to us that it may be suggested that the adverse movement in losses seen in the reported data for 2009/10, whilst utterly unrepresentative of the performance in that year, should be allowed to stand because it represents the correction of windfall gains that arise from an understatement of losses in earlier years. This would not be a correct view. In evaluating this aspect of the situation it is important to bear in mind that many of these changes relate to longstanding errors, such as long-term vacant properties. The losses targets for the DPCR4 period were set on the basis of reported losses that had not been disturbed by the recent supplier activity. What matters in terms of distributor performance and obligations is that the targets and the reported performance are

measured as consistently as possible with one another. Even if it can be established that the 2009/10 data includes losses from prior years, the discontinuity between the basis on which the targets were set and the way that suppliers have adjusted prior years' data would justify a change to the method of calculation of the 2009/10 losses performance. We have also modelled the effect of changes such as this and have confirmed that the combined operation of the DPCR4 losses incentive, the DPCR4 losses roller, the DPCR5 targets and the DPCR5 reported performance will (all other things being equal) result in a distributor suffering a financial penalty in both nominal and NPV terms. In short:

- the DPCR4 targets did not allow for the changes; therefore
- the DPCR4 reported losses will move adversely (relative to the DPCR4 targets); and
- the DPCR4 losses roller will interpret the profile of performance as one of deterioration since losses that would have been reported early in the DPCR4 period are concentrated in the later years.

As far as DPCR5 is concerned:

- the DPCR5 target will be based on an average of the DPCR4 actuals; so
- the negative impact of the changes is diluted in the target to the extent that the adjustment does not cover the whole of the DPCR4 period; whereas
- the negative impact of the change will be reflected in every year's reported losses in DPCR5.

17. Unless further changes are made to the supplier volume allocations relating to the regulatory year 2009/10, NEDL and YEDL expect that, in accordance with paragraph 9 of the Condition, they will each request the agreement of the Gas and Electricity Markets Authority (the Authority) to enable NEDL and YEDL to calculate  $AUD_t$ , and  $L_t$ , on a basis that differs from the basis that was used in the relevant year commencing 1 April 2002. The proposed revised approach to the calculation of distribution losses for NEDL and YEDL is something that CE wishes to discuss with Ofgem prior to making a formal application for the agreement of the Authority to a change in the basis



of the calculation. NEDL and YEDL have thus far refrained from making a formal application to the Authority because it was our understanding that Ofgem would investigate the matter itself and, if appropriate, an application could be made that would enable the Authority to make a decision with the benefit of the information made available to it as a result of the *Consultation*.

**EVIDENCE OF UNUSUAL SUPPLIER ACTIVITY AFFECTING THE OUTPUTS FROM THE SETTLEMENTS SYSTEM**

- 18. Electricity distributors have almost no visibility of the data and processes that suppliers use to determine the data that is input into the Settlements system. CE has consulted with Elexon, which has responsibility for delivering the BSC, other distributors, some of whom have witnessed similar late changes to data relating to their company, and three electricity suppliers, namely British Gas, npower and EDF Energy.
- 19. The information set out below represents a summary of CE’s view of the nature, extent and cause of the recent changes to supplier volume allocations, based on the data and information that are available to CE in the circumstances.
- 20. The Authority has the benefit of widely drawn information powers that will enable it to confirm or amend the account given by CE in this response. CE was alerted to this issue because the reported losses derived from the data from the settlement system were not following the expected trend. This is illustrated in figures 1 and 2 below.

Figure 1 - NEDL losses performance

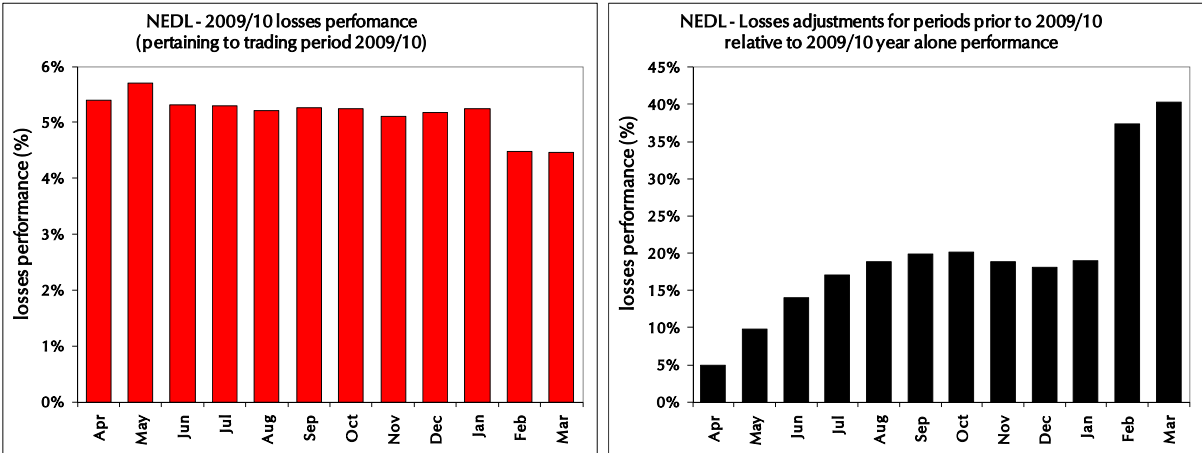
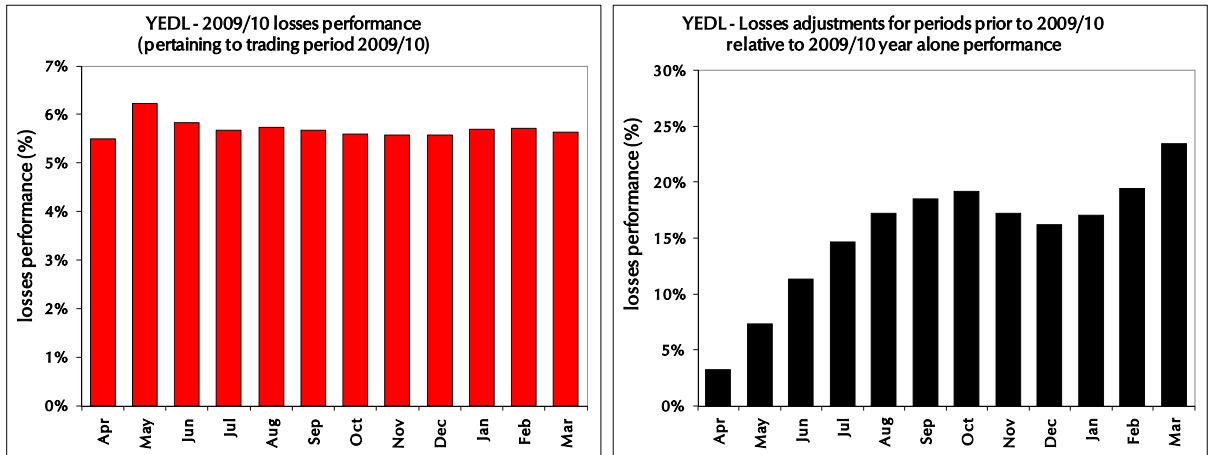


Figure 2 - YEDL losses performance



21. It is clear from figures 1 and 2 that, while the losses relating to 2009/10 were remaining stable, significant adjustments were being made for the period prior to 2009/10, particularly during February and March 2009.
22. We have established with the help of Elexon that the changes are not explained by any change in the volume of settlements data that is based on actual meter readings by final reconciliation (RF).
23. It is also clear that settlement reconciliations are becoming increasingly volatile. This is illustrated by figures 3 and 4 below:

Figure 3 – NEDL reconciliation movements

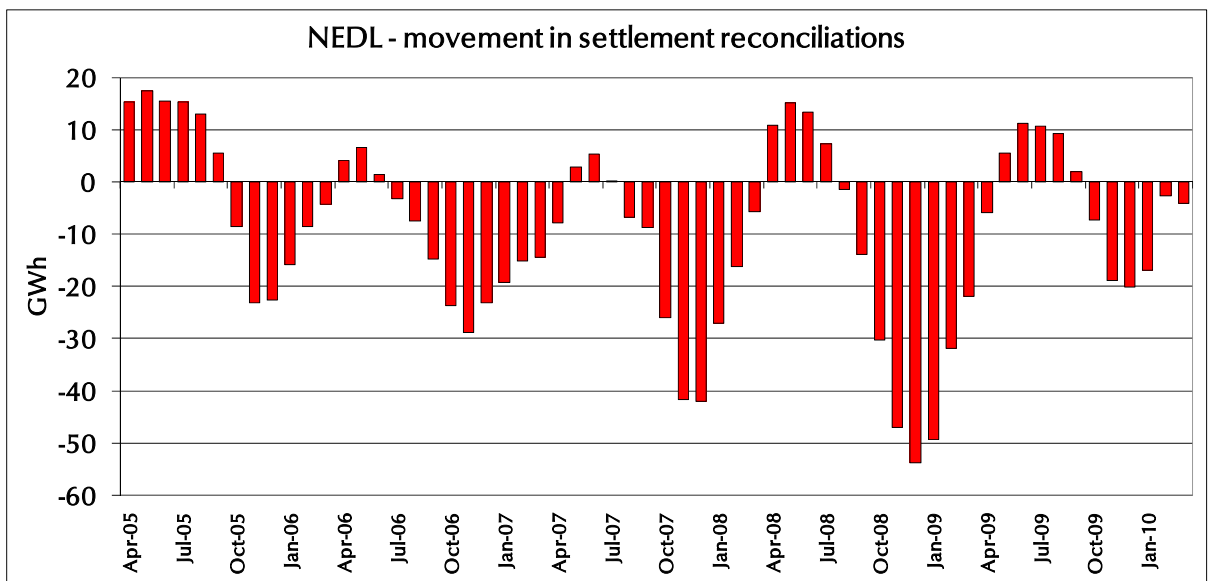
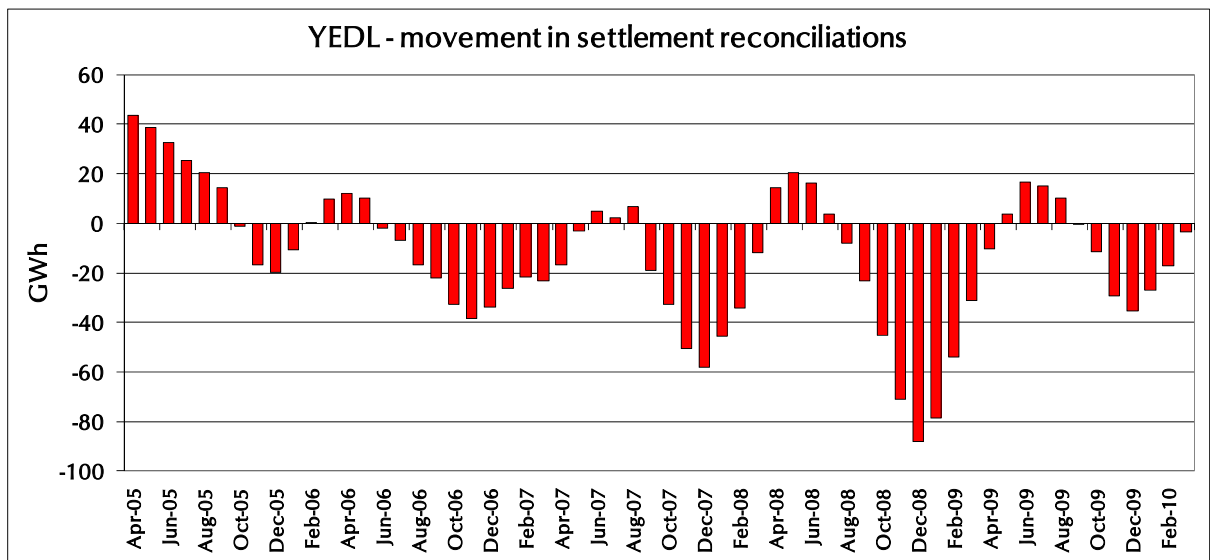


Figure 4 – YEDL reconciliation movements



24. Figures 3 and 4 show a consistent seasonal pattern to the reconciliation movements but the magnitude of the reconciliation movements has steadily increased throughout the DPCR4 period. The more recent reconciliation movements appear lower because not all of the reconciliation runs have been completed for those months.
25. Furthermore, CE has identified a surge in dispute final (DF) movements driven by supplier data management activity that is highly unusual. This is shown in figures 5 and 6 below.

Figure 5 – NEDL DF reconciliation movements

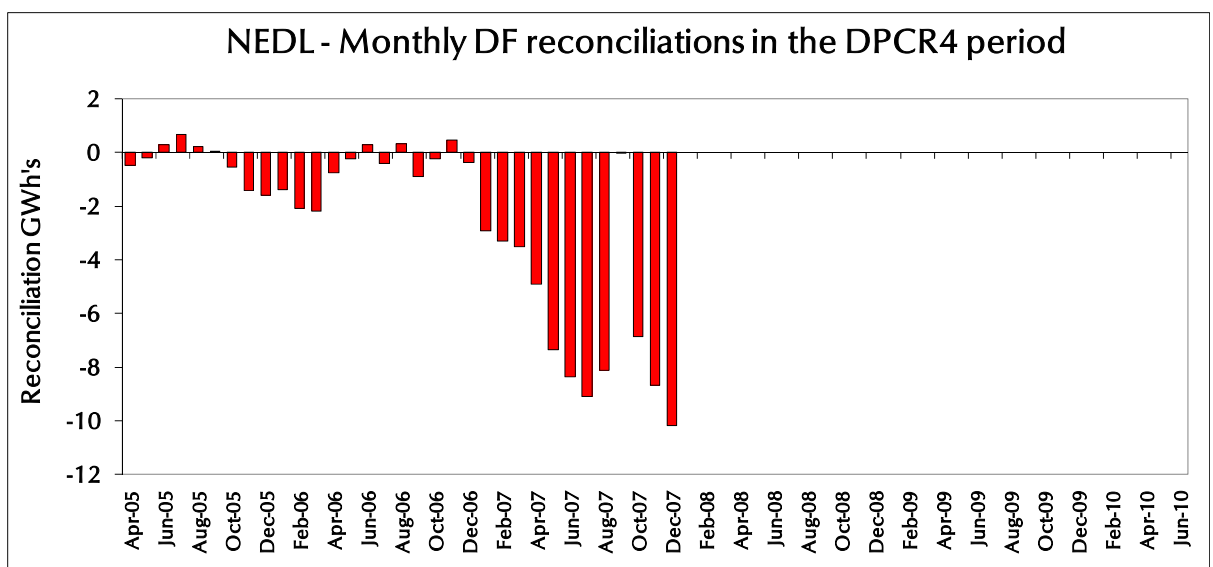
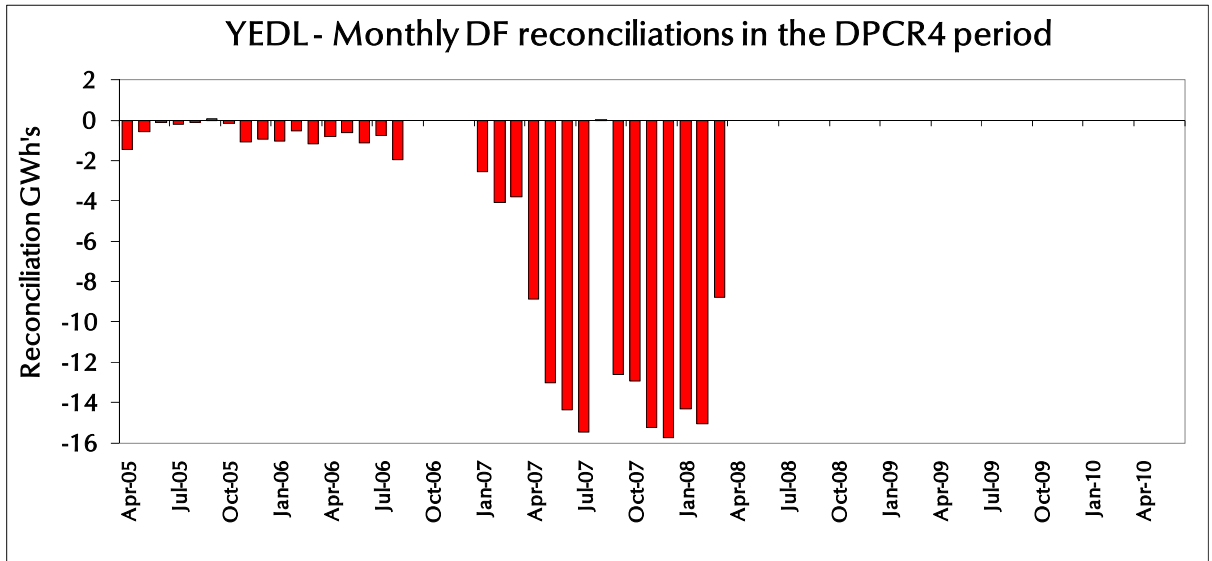
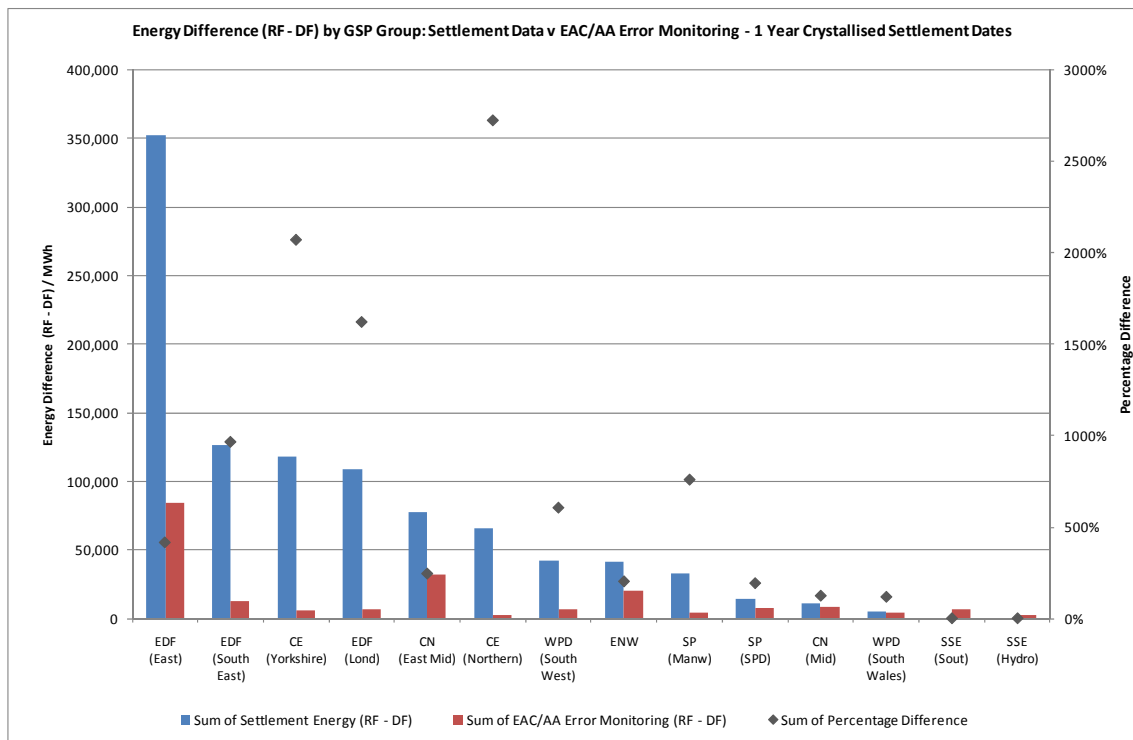


Figure 6 – YEDL DF reconciliation movements



26. Figures 5 and 6 show that the level of DF reconciliation movement remained stable and relatively low throughout most of the DPCR4 period until May 2009, when the level of movement significantly increased. Coincidentally in May 2009 there was a meeting between Elexon and suppliers where the use of GVC was discussed.
27. Elexon has confirmed to CE that the reconciliation movements between RF and DF have been much higher than it had expected. This is shown in figure 7 below, which has been provided by Elexon, where the red bars indicate the level of movement Elexon expected to happen between RF and DF based on its monitoring of large supplier volume allocations and the blue bars show the level of actual movement occurring between RF and DF. The diamonds indicate the percentage difference, and as the blue bars exceed the red bars the level of movement is above Elexon's expectations.

Figure 7 – Elexon comparison of expected and actual reconciliation movements between RF and DF



28. Our understanding, which has been built up during our investigations and our discussions with suppliers, is that most of these changes reflect longstanding data integrity issues that date back to before DPCR4. Suppliers have also informed us that they have made corrections for errors that occurred prior to the start of the DPCR4 period.
29. Suppliers' initial responses when we raised these matters in discussion were sometimes to say that the distributor had benefited from lower reported losses before the error was corrected and therefore the correction was neutral over a period of time. However, in reality, because the errors existed in many cases prior to the start of the DPCR4 period the error was included in the data from which our DPCR4 target was calculated. Therefore, as the error would have been in both the target and the reported actual numbers, the distributor gained no additional losses benefit from the error.

**THE USE OF THE GROSS VOLUME CORRECTION FACILITY**

30. Elexon became concerned about the use of a facility within the settlements system known as GVC. Although Elexon does not hold disaggregated data on GVC, it

believes that the recent exceptional movements in settlement reconciliations may arise from the increased use of this facility by some suppliers.

31. Although distributors have no visibility of the underlying data, our discussions with the three suppliers referred to above confirm Elexon's hypothesis that the use of the GVC facility largely explains the significant changes in settlement reconciliations. We have been unable to find any other facility within the Settlements processes that has the potential to be used on such a scale as to produce the changes that we have observed. However, one supplier has told us that GVC is only one of many mechanisms that can be used to change Settlements data relating to supplier volume allocations.
32. Elexon has described GVC as follows:

'GVC is a technique used to correct errors relating to Meter Advance Period during which some Settlement Dates have already been subject to a last reconciliation run (whether a Final Reconciliation or Post Final Settlement Run) - i.e. where part of the error has 'crystallised' in Settlement. It applies the principle that the total gross volume of energy for a given Metering System should be correct. Where energy has been misallocated to a range of Settlement Dates within a Meter Advance Period which have passed through the last reconciliation run, GVC can be applied to reallocate the lost or gained energy volume to a range of Settlement Dates which have not yet been subject to a last reconciliation run – termed the 'fluid' period. This process ensures that the total gross volume of energy is correct, although allocated to the wrong Settlement Dates/Settlement Periods.

GVC was introduced in March 2000 as a technique to address errors due to erroneous Large EACs and AAs in Settlement. Its use was later described in BSCP504 Section 4.14. Today GVC use is much broader. Under the current arrangements it can be used to address almost any NHH consumption error, *no matter how old*, and as such is a very powerful technique. GVC was introduced at a time when electricity prices were fairly constant, and the financial impact of settling energy in an incorrect Settlement Period was relatively low. Electricity prices since have not only become far more volatile but have also risen dramatically. As a result the

impact is far greater, particularly (for example) energy taken in Settlements Periods in excess of 5 years ago is settled at today's market prices.' (Emphasis added.)

33. In August 2009 Elexon took steps to apply controls to the use of GVC and as a result a change was made to the BSC that applied some restrictions to its use. The decision to apply new constraints to the use of GVC was confirmed in October 2009 but the effective date of the application of the new rules was 1 March 2010. The rule change appears to have provided an impetus to those suppliers that were making extensive use of GVC to *increase* their use of the technique in those circumstances where it would soon cease to be applicable. However, it should be noted that the facility has not been withdrawn and its continued availability has implications for the close-out of the distribution losses incentive in the DPCR4 period, the setting of the losses targets for the DPCR5 period and the calculation of losses in the DPCR5 period.
34. For the purposes of this response to the *Consultation* the key points to note about the increased use of GVC are:
- under the arrangements that prevailed until 1 March 2010 GVC could be used to address almost any non-half hourly consumption error, *no matter how old*;
  - GVC results in adjustments to the energy attributed to suppliers appearing in a settlement period that is still open in order to compensate for a historical period, after DF, where readings are now crystallised (i.e. a period in respect of which the readings cannot be changed);
  - contrary to Ofgem's view as set out in the *Consultation*, at least one large supplier believes that the rule change relating to GVC does not restrict a supplier's ability to make retrospective GVC adjustments, but merely removes the opportunity for suppliers to request GVC at DF; and
  - large-scale corrections, spanning many years, may be compressed into the 2009/10 settlement runs, thus concentrating the effect into a single regulatory year.

35. As a result, unless the 2009/10 data is changed or the Authority agrees to NEDL and YEDL using a different basis for the calculation of  $AUD_t$  in respect of the relevant year 2009/10:
- the reported losses performance and revenue driver of NEDL and YEDL will be adversely affected, giving rise to over-recoveries of £11.891m and £22.895m respectively in that relevant year;
  - the licensees will be unable to distinguish between losses that occurred in the DPCR3 and DPCR4 periods and will be unable to apply the correct incentive rate to the losses that are now being reported;
  - the targets for the DPCR5 period will be distorted by the abnormal data in respect of 2009/10; and
  - the reported outturn in the DPCR5 period will continue to be distorted by the continuing use of the GVC facility.

**OFGEM'S PROPOSALS WITH RESPECT TO RELIEF FROM THE PENALTY INTEREST RATE AND THE SETTING OF USE OF SYSTEM CHARGES IN 2010/11**

36. In the *Consultation* Ofgem sets out the reasons why it is minded to provide relief from the penalty interest rate (applicable in 2010/11 in respect of over-recoveries in 2009/10) where a DNO can show:
- (i) its reportable losses for 2009/10 were abnormally high as a result of settlement data adjustments;
  - (ii) those adjustments were unrelated to actual network performance and were outside its control; and
  - (iii) if those adjustments had not arisen, the DNO's recovery would have been less than 103 % of allowed revenue.
37. Ofgem further states that, if appropriate, it would expect to apply the same rationale for the penalty interest rate adjustment for the regulatory year 2011/12.



38. In our view Ofgem's 'minded to' position with respect to the application of the penalty interest rate is soundly based.
39. In the case of NEDL and YEDL we have demonstrated above that the late changes to supplier volume allocations relating to the relevant year 2009/10 were a significant factor in the movement in the over/under-recovery position of NEDL and YEDL as shown in the table below.

	<b>NEDL</b>	<b>YEDL</b>	<b>CE</b>
<i>Final proposals</i> forecast of 2009/10 over-recovery (December 2009)	£1.775m	£4.203m	£5.977m
Publication of 2010/11 tariffs (February 2010)	£2.5m	£6.3m	£8.8m
SLC47 reported over-recovery (March 2010)	£11.891m	£22.895m	£34.786m

40. The table above demonstrates that, based on the data we had available at the time the *Final proposals* were issued, we already anticipated NEDL being £1.775m over-recovered and YEDL being £4.203m over-recovered at the end of 2009/10.
41. By the time we published the final charges for 2010/11 in February 2010 the position had worsened due to further negative reconciliations (at this point we had processed data up to December 2009). We recognised this in our tariff setting and included an £8.8m correction (K<sub>1</sub>) for 2009/10 over-recovery in the 2010/11 allowed income calculation.
42. However, as demonstrated in figures 1 and 2, the reconciliation movements significantly increased over the period January 2010 to March 2010, resulting in the 2009/10 over-recovery position increasing to £11.891m in NEDL and £22.895m in YEDL. We had no means of anticipating such a shift in reconciliation movements ahead of publishing our final charges for 2010/11.
43. In May 2010 CE considered whether a mid-year (i.e. October 2010) tariff change was necessary and entered into informal discussions with Ofgem on the point. CE decided,

primarily for the reasons set out at paragraph 22 of the *Consultation*, that no mid-year tariff change should be made.

44. Given the significant movement in the over-recovery position from the £8.8m that we expected when we set the 2010/11 use of system charges to the £34.786m that looked likely when we were preparing our price-control returns for the year 2009/10, we agreed with Ofgem that the price-control return for that year would have to be submitted on a provisional basis if we were to meet the licence deadline for submission and we were to use the same method for the calculation of losses that we had used in previous years. We explained to Ofgem that we expected that further information about the reported level of losses in 2009/10 would lead to a resubmission of the price-control data for that year at some later date when better information was available.
45. CE also considers that the obligation placed on a licensee by paragraph 2 of special condition CRC3 (i.e. to ‘take all appropriate steps within its power’ to ensure that it does not over-recover) is an obligation that applies only at the time that the licensee is setting its charges. It is not an obligation that applies once the charges have been set or at other times. Accordingly, CE considers that a licensee that set charges to target a zero over-recovery position, taking into account the best available information at the time when the charges were set, has met its obligations under this paragraph. The alternative interpretation would imply a continuing duty throughout the year to take all appropriate steps to bring actual and allowed income into line. This would not be practicable, neither would it be consistent with the opening words of the paragraph namely: ‘The Licensee *in setting* Demand Use of System Charges...’ (Emphasis added). Furthermore, such an interpretation is unnecessary to incentivise a licensee to avoid over-recovery. That incentive is provided by the interest penalty and the powers given to Ofgem when over-recovery exceeds the prescribed threshold of 5%. Ofgem’s interpretation would imply that licensees should act *at all times* to bring their actual and allowed income into line (by the year-end), which would be contrary to regulatory policy, and contrary to the intention of the distribution connection and use of system agreement (DCUSA).
46. Accordingly, whilst we agree with Ofgem that no mid-year changes to charges in 2010/11 should be made, we do not agree that this requires any change to the wording of paragraph 2 of CRC3.

47. Given that:

- the over-recovery at the end of 2009/10 could not be prevented;
- use of system charges for 2010/11 were properly set to target a zero over-recovery having regard to the best information available at the time; and
- it was unnecessary and undesirable to introduce a mid-year tariff change in 2010/11,

we agree with Ofgem's 'minded to' position with respect to penalty interest. The penalty interest rate should not apply to the over-recoveries of NEDL and YEDL as at 31 March 2010 or 31 March 2011.

48. Licensees that can meet the tests set out in the *Consultation* should be relieved of the penalty interest rate irrespective of the conclusions that Ofgem reaches on the substantive issue of the fitness of the reported Settlements data for the calculation of the losses incentive under the DPCR4 losses incentive and in the DPCR5 period.

#### **AGREEMENT OF THE AUTHORITY TO CHANGE THE BASIS OF CALCULATION OF AUD<sub>t</sub> IN RESPECT OF THE RELEVANT YEAR 2009/10**

49. Paragraph 9 of the Condition provides as follows:

‘The licensee shall, unless otherwise agreed by the Authority, calculate each component of adjusted distribution losses for the relevant year *t* on the same basis as that used within the calculation of adjusted distribution losses in respect of the relevant year commencing 1 April 2002....’

50. NEDL and YEDL contend that, without an appropriate change to the way that adjusted distribution losses are calculated, the underlying purpose of the Condition will not be met. That purpose is set out in paragraph 1 of the Condition, which states:

‘The purpose of this condition is to establish the amount of incentive that adjusts allowed demand revenue *so as to reflect the performance of the licensee under the scheme set out below in respect of distribution losses.*’  
(Emphasis added.)

51. NEDL and YEDL intend to request that the Authority should exercise the discretion implied in paragraph 9 of the Condition and agree to NEDL and YEDL calculating adjusted units distributed in 2009/10 on a basis that irons out the distortions in the data that have been explained above.
52. NEDL and YEDL would like to discuss with Ofgem the best way to calculate 2009/10 losses before making a formal request that the Authority exercise its discretion to permit NEDL and YEDL to calculate the losses on a different basis.