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31 August 2010

Dear Paul,

Relief from the consequences of over-recovery on the basis that accelerated gross volume corrections may have distorted losses reporting

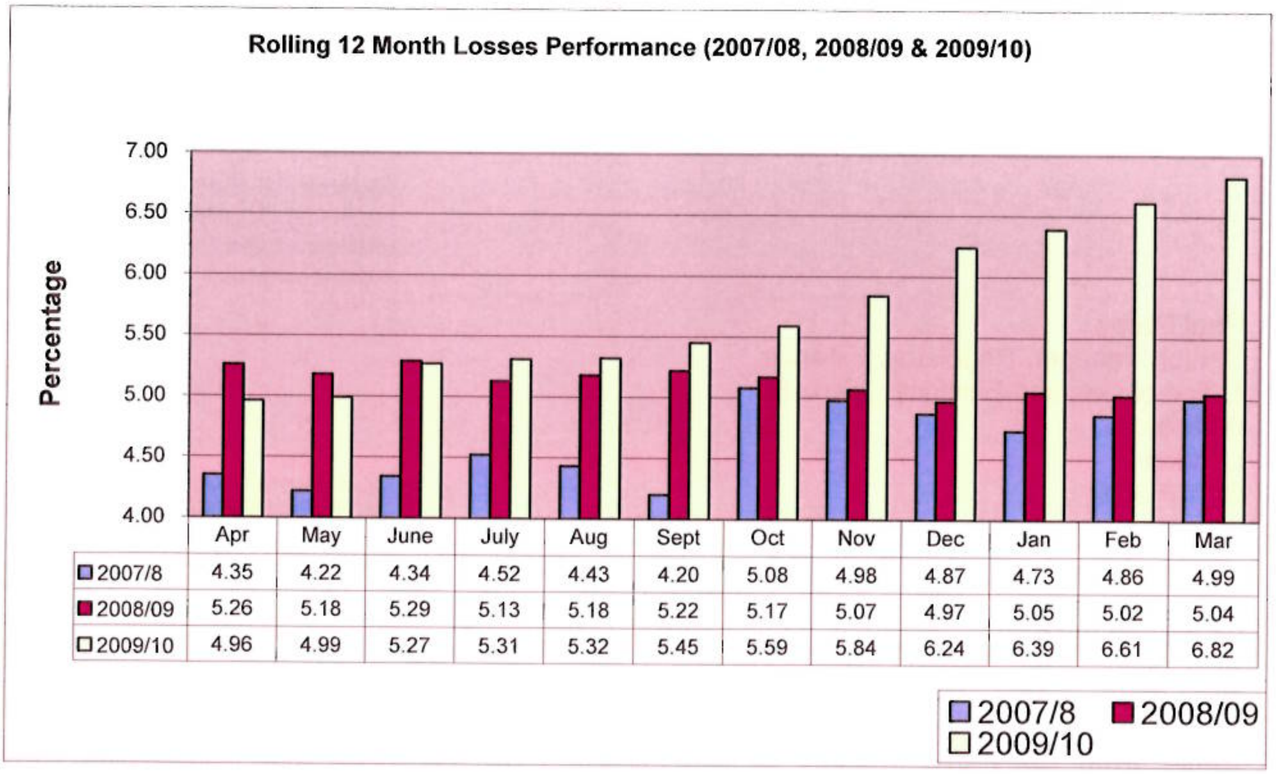
Thank you for your consultation on the relief from the consequences of over-recovery due to the gross volume corrections distorting losses reporting. We are supportive of the 'minded to' position set out in the letter not to require DNOs to reduce Use of System charges in October 2010, providing we can satisfy you of the matters set out in the letter.

We have undertaken various investigations to gather the evidence needed to support our assertion that 2009/10 distribution losses were atypically high. These investigations involved internal analysis of settlement data and distribution losses trends up to July 2010. We have also written to a number of electricity suppliers and Elexon to ask them to assist us in understanding why 2009/10 settlement movements in the Non Half Hourly market were significantly different from what we had experienced historically.

Internal Analysis

1. We have compared the daily differences over a 12 month period (July 2009 to June 2010) between Reconciliation Final (RF) and Dispute (DF) for our most popular tariff, Domestic Unrestricted. The movement between RF and DF are, according to Elexon, when Gross Volume Corrections are likely to occur. Every day over the period, without exception, showed a negative adjustment. In the first half of the period the average monthly adjustment was 1500MWh, compared to 1050MWh in the second half of the period. This equates to a 30% drop in the adjustment between the two periods

2. The graph and table below show our historical performance on losses over the last three reported years. In addition the table shows the year to date performance for 2010/11 up to July 2010.



	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar
2007/8	4.35	4.22	4.34	4.52	4.43	4.20	5.08	4.98	4.87	4.73	4.86	4.99
2008/09	5.26	5.18	5.29	5.13	5.18	5.22	5.17	5.07	4.97	5.05	5.02	5.04
2009/10	4.96	4.99	5.27	5.31	5.32	5.45	5.59	5.84	6.24	6.39	6.61	6.82

	2007/08	2008/09	2009/10	2010/11 YTD
Actual losses (GWh)	1278	1277	1639	
Actual losses (GWh) April to July	489	547	615	541
12 month rolling average as % of units distributed	4.99%	5.04%	6.82%	

It is clear from this trend that the losses in 2009/10 were atypically high, and that the early months of 2010/11 are showing a return to much lower levels.

External Analysis

We have engaged with Elexon and the main electricity suppliers in our distribution area. Unfortunately none of these parties have been able to produce the sort of information that we needed to either understand the issue of Gross Volume Corrections (GVC) more clearly or provide evidence of increased activity levels. We are concerned that they have been unable to provide this information even though the guidance notes on the application of gross volume correction clearly state that an appropriate audit trail must be used whenever gross volume correction is used.

Although we are disappointed that suppliers have not been able to provide us with conclusive information, it has reinforced our belief that the audit trails that should have been maintained whenever GVCs were used have not been implemented, or that the reporting regime to monitor overall activity is deficient in some way.

Interest rate adjustment to over recoveries

In our 2009/10 Revenue RIGs submission, we reported RDt of £270.1m and ADt of £253.7m, with a resulting correction of £16.4m. This represents a 6.5% difference. In order to achieve a 103 per cent level of allowed revenue recovery we would be required to reduce the correction by approximately £8.6m to £7.8m, with a resulting ADt of £262.3m.

An increase of £8.6m in allowed revenue equates to an adjustment of 150GWh to units distributed, with a consequent reduction in actual losses. Each GWh has been valued at £57 per MWh as per Standard Licence Condition C1

Based on 2010/11 losses performance to July 2010, we would expect to improve by more than 150GWh. In the first 4 months we have already improved against 2009/10 by 74GWh on units distributed that are similar to last year.

Based on the average of the last 3 years, by the end of July, 39% of total year losses have occurred. Using this ratio for 2010/11 would produce losses of 1390GWh, an improvement of some 250GWh.

Conclusions

We believe that we have adequately demonstrated that:

1. Reported 2009/10 losses are abnormally high as a result of settlement data adjustment.
2. These adjustments are unrelated to actual network performance as demonstrated by the marked but short term improvement during the early part of 2010/11,
3. If they adjustments had not arisen, Electricity North West would have been able to maintain allowed revenue within the 103 per cent banding,

We therefore request that penal interest is not applied to the over-recovery positions for 2009/10 and 2010/11 and that we will not adjust Use of System charges in October 2010. We also recognise that suppliers are not normally in favour of October price adjustments particularly where this will be reversed in the following April.

Yours sincerely,

Tony McEntee

Tony McEntee
Head of Commercial Policy