



Electricity Distributors, Electricity
Suppliers and other interested parties

*Promoting choice and
value for all customers*

Our Ref: Smarter Grids & Governance
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14 December 2010

Dear Colleagues,

The Authority's decision on requests for relief from the consequences of over-recovery of allowed revenue caused by gross volume corrections (GVC) in settlement data

1. Our letter (Ref 87/10) dated 20 July 2010¹ gave the background to representations made by two electricity distribution network operator (DNO) groups for relief from the penalty rate of interest associated with over-recoveries of price control allowed revenue. The basis for the representations was that high levels of gross volume corrections (GVC) to settlement data by electricity suppliers had artificially reduced the performance of the DNOs concerned under the electricity distribution losses incentive scheme, causing a reduction in allowed revenue which they could not reasonably have foreseen.
2. In our letter of 20 July we set out information on the losses incentive scheme and how changes to levels of GVC might affect its operation. We also explained the interest rate adjustment mechanism (the 'PRT' term) which normally applies to over-recoveries of allowed revenue.
3. Although only limited information is presently available on the overall effect of GVC on losses reporting, we considered it likely that, for some DNOs, atypically high levels of GVC adjustments would have significantly increased reportable loss levels for 2009-10 and that this effect could continue into 2010-11. In those circumstances we said that we were minded to provide the relief from the penalty interest rate where a DNO could show to our satisfaction that:
 - (i) its reportable losses for 2009-10 are abnormally high as a result of settlement data adjustments;
 - (ii) those adjustments are unrelated to actual network performance and are outside its control; and
 - (iii) if those adjustments had not arisen, the DNO's recovery would have been less than 103 per cent of allowed revenue.

¹

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/Consultation%20on%20implications%20of%20gross%20volume%20corrections%20for%20DNO%20revenues.pdf>

We also said that we were minded to allow DNOs who satisfy us with respect to the matters set out above to not reduce their use of system tariffs in October 2010², unless there was another regulatory reason for doing so.

Decision on interest rate adjustments to over recoveries

4. We have received information from four DNOs (four licensees belonging to three corporate groups) which satisfies the criteria set out in paragraph 3 and we have therefore decided that the value of PRt for those DNOs ought to set be at "1.5" instead of "3" for regulatory year 2010-11. The DNOs concerned are:
 - Northern Electric Distribution Ltd,
 - Yorkshire Electricity Distribution plc,
 - Electricity North West Ltd, and
 - Eastern Power Networks plc (formerly EDF Energy Networks (EPN) plc).
5. We have also decided that, to the extent that those DNOs would normally have been required, under special condition CRC 3.2 (Part A: Licensee's obligation) of their licenses, to reduce their use of system charges during 2010-11 to avoid a further over-recovery, we will take no action in respect of the licensees concerned where they have decided not to effect a reduction in charges which would have been driven by the GVC issue. We will consider any additional requests relating to the value of PRt for regulatory year 2011-12 once relevant information has become available during that year.
6. To give effect to the decisions above we will give notice of proposed modifications to Special Condition CRC 14.2 (Part A: Interest adjustment for over and under recoveries of revenue) in the licences of the DNOs concerned so that the value of PRt for Regulatory Years 2010-11 and 2011-12 can be set in a direction given by the Authority in each of those regulatory years. The notices will be accessible on our website³. We do not now consider that a modification of special condition CRC 3.2 (as referred to at paragraph 23 of our letter of 20 July 2010) is required. The licensees will be asked to consent to these changes.

Implications for substantive losses incentive adjustments and the DPCR4 revenue driver

7. In 2008-09 the four DNOs referred to above reported reward adjustments under the losses incentive scheme totalling £38 million, whereas in 2009-10 the same four DNOs reported penalty adjustments totalling £54 million. This could be expressed as a reduction of 170% for comparison to the change for all the other DNOs which amounted to an increase of 98%. Although volatility is known to subsist in settlements data the figures suggest that the GVC issues could have significantly affected outcomes under the losses incentive scheme.
8. Some information is available from the settlements system on aggregate deductions from the totals of units distributed during 2009-10 under GVC adjustments. However, much less information appears to be available concerning the history of the metering errors which those GVC adjustments were intended to correct. In particular it appears that there is only limited information concerning the periods over which those totals accrued. To give a simple example, a GVC deduction of 100 units might relate to an over reading of 50 units at a meter point for each of two years, or an over reading of 10 units for each of ten years. This aspect is important in considering the effect which

² A reduction might otherwise be required under Special Condition 3.2 of the Electricity Distribution Licence

³ <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Pages/Policy.aspx>

GVC might have had on the losses incentive overall because of the way in which a DNOs performance is compared to its own historical performance.

9. We will therefore consider any further representations from DNOs for relief from penalty adjustment for 2009-10 on their merits and in light of all available information, including the opinion of the Appropriate Auditor referred to under Standard Condition 47 (Reporting of Price Control Revenue Information) of the Electricity Distribution Licence. Such representations would be likely to take the form of a request for agreement to restate numbers of units distributed on a different basis of calculation under paragraph 9 of Licence Special Condition C1⁴.
10. In reaching any decisions on such representations we will also take into account following factors:
 - (i). The timing of the representation and any consequences that a change in allowed revenue would have on use of system charge setting by the DNO concerned. In particular we shall seek to avoid circumstances under which electricity suppliers are faced with late notice of changes to a DNOs charges
 - (ii). The fact that a revenue adjustment in respect of the losses incentive scheme will, in any case, have to be applied to all DNOs under Special Condition CRC 7 during 2012 which would provide an opportunity to apply any further adjustment which might be appropriate.
11. Any queries or comments regarding the content of this letter should be sent for the attention of Paul Darby, Senior Manager, Regulatory Finance or emailed to regulatoryfinance@ofgem.gov.uk.

Yours sincerely,



Rachel Fletcher
Partner, Distribution

⁴ This reference is to the Electricity Distribution Licence in the form which it was in up to 31 March 2010, which remains the appropriate reference for issues pertaining to losses reporting for regulatory year 2009-10.