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Submitted by e-mail to:

Lesley Ferrando, Ofgem at lesley.ferrando@ofgem.gov.uk

Consultation on the way forward in dealing with the interaction between the electricity distribution losses incentive scheme and Gross Volume Correction (GVC) activity

Dear Lesley,

General

1. Thank you for the opportunity to comment on this important issue.

2. Firstly, we believe the steps Ofgem has outlined within this open letter, to bring clarity and order to the timetable for dealing with this issue, are very sensible and welcome. This will help manage the uncertainty and reduce or remove the risk of sharp short-notice increases in distribution charges.

3. We recognise that this is not a simple or straightforward issue. As such, we believe it is necessary to convene an industry working group to consider potential solutions. To this end, we were pleased that the DNOs agreed to hold an initial meeting, following a request from the supplier community at the April DCMF. We would also suggest Elexon involvement in this group.

4. Although we offer some comments below, it is difficult to critique the CE Electric solution as we are yet to see any quantitative supporting evidence or any detailed explanation. Similarly, it is difficult to understand the impact of GVC on DNO reported losses, and so the suitability of any possible solutions, as the various losses reporting methodologies are not explained.

5. Although we recognise it is early in the process of 'closing out' the 2005-2010 losses incentive scheme, we are concerned that this issue is being considered in isolation. It is important that the losses target and performance are 'like-for-like'. This can only be achieved is all developments to settlements are considered, otherwise it will 'cherry-picking'.

CE Electric Solution

6. GVC is a legitimate settlements process which was not invented in 2009/10. The issue appears to be that an abnormally high level of GVC took place in 2009/10. A base level of GVC would be expected and so it would be more reasonable to 'normalise' RF and DF reconciliations rather than ignore entirely.

7. We believe the majority of GVC activity in 2009/10 is likely to have taken place at DF. We remain unclear about the impact of GVC on earlier settlements runs and so see no reason to adjust these at all. If evidence can be provided that proved otherwise, we would be happy to consider other solutions.

8. So, if an adjustment is to be made for GVC, normalising DF (and potentially RF) data and leaving other runs unadjusted would appear, on the information we have, to be a preferable solution.

Settlements issues

9. We support a Losses Incentive scheme that rewards DNOs when the energy customers are required to buy to cover losses is shown to be reduced by their activities. This should bring a benefit to customers and the environment, with, in the short-term, customers being broadly financially neutral as the incentive is offset by the reduced energy costs.

10. However, changes to settlements processes during DPCR4 that reduce non-technical losses by increasing volume in settlements do not reduce the amount of energy customers, as a group, are required to buy (with the exception of theft detection); the energy is simply redistributed between customers via the Group Correction Factor. Hence, customers are required to pay for the losses incentive revenue without any reduced energy costs.

11. Whether this 'data quality' incentive was the intention at the time the scheme was set is unclear. For data issues the value of the incentive is far too high as it is set on the basis of the value of the energy saved, when generally there won't be any overall energy saving arising. Any 'data quality' incentive, whilst likely to improve data accuracy at a site-level, brings a strong commercial incentive to bias settlements towards over-statement at a total level.

12. This is why we believe that it is necessary for all changes to settlements processes and practices to be considered if adjustments to settlements data are to be made when calculating losses incentive payments.

Conclusion

13. We believe that further information should be provided to the industry to allow improved understanding and analysis:

    - Fuller description of the CE Electric decision
    - Supporting data to the CE Electric decision
    - All relevant Losses Reporting Methodologies

14. Support should be given to an industry working group to consider:

    - Potential solutions to the GVC impact
    - Other settlements issues for consideration
    - Data requirements

15. Please contact me if you wish to discuss this response in more detail.

Yours sincerely,

Andy Manning
Head of Transmission and Distribution