

BY EMAIL



28 April 2011

Lesley Ferrando
Ofgem
9 Millbank,
London,
SW1P 3GE

Your Ref: SG&G/Distribution

Dear Lesley,

Response to your consultation on the way forward in dealing with the interactions between the electricity distribution losses incentive scheme and Gross Volume Correction (GVC) activity

Changes observed in Settlement volumes

Like the DNOs, we have observed atypical variations in Non Half Hourly (NHH) energy volumes between the Initial Settlement (SF) Run and later reconciliation runs for Settlement Dates during regulatory years 2008/09 and 2009/10.

We believe these variations are partly attributable to the recession. At the earlier run types, NHH Settlement is based largely on Estimated Annual Consumption (EAC) values, which in turn are derived from historical consumption. As these EAC values are replaced at later Run Types by Annualised Advances (AA), which are derived from the latest readings, the overall energy volume will reduce in a period of falling consumption. However, when the effect of the recession is measured in terms of reductions in GSP Group Takes (i.e. the volume of energy taken from the transmission network onto distribution networks), a significant proportion of the reduction can be seen to be attributable to Half Hourly metered (i.e. larger non-domestic customers). The reduction in energy volumes for NHH metered customers is in excess of the expected recessionary effect, as observed via the difference between falling GSP Group Takes and falling Half Hourly metered volumes.

This suggests that the drop in NHH metered energy relates not just to the recession, but (and to a greater degree) to adjustments to energy values relating to earlier periods, for which the Final Reconciliation Run has already taken place. Gross Volume Correction (GVC) is frequently referenced in Ofgem's earlier letters, but is not the only contributing factor. NHH metered processes are, by nature, self-correcting. For example, if consumption at a vacant premise has been over-estimated for a number of years and access is gained and a reading taken, this can lead to a negative metered advance, which compensates for the previous over-estimation. We have seen more examples of this in recent years as a result of additional effort on the part of Suppliers and their agents to gain access to such sites (both as a means of improving their performance against Settlement targets and also as part of reconciling their own purchases and sales).

Use of Gross Volume Correction

Although not the only factor, GVC has made a significant contribution to the atypical reductions in energy volumes across Run Types which have been observed over the last two years. Market observation and anecdotal evidence from Suppliers and DNOs indicate that there was an increase in the use of GVC ahead of changes to the relevant BSC Procedure in February 2010 limiting the use of GVC.

The increased use of GVC has also led to an increase in the volume of negative forward EACs. Changes to the relevant BSC Procedures in June 2010 mean that negative EACs are automatically replaced by Profile Class average values. This automatic replacement only occurs once meters have been read, so there remains a residual volume of negative EACs awaiting replacement. By the Final Reconciliation Run at 14 months, about 97 to 98% of NHH energy is settled on Annualised Advances. However, there is some evidence that the replacement rate for negative EACs is lower than normal.

Approach to correcting for GVC distortions in DNOs losses reporting

Whilst the individual actions that make up GVC, like withdrawing and 'deeming' reads, are subject to audit requirements, Suppliers are unlikely to be in the position where they can readily identify the volumes of energy resulting from GVC adjustments and quantify the effect of any adjustments in relation to earlier regulatory years. As such a "bottom-up" approach to correcting for GVC distortions appears impractical.

A "top-down" approach using some form of normalisation based on earlier years would seem the most workable method.

If the effect of negative EACs is to be included in such a method, account needs to be taken of the likely replacement of these negative EACs by positive AAs by the Final Reconciliation Run. Consideration should also be given to the extent to which any 'normalisation' approach already includes the effects of negative EACs, in order to avoid the double-counting of any impacts.

If you receive any suggested improvements from respondents that you would like our views on from a BSC perspective, please do not hesitate to get in touch.

I can be contacted on 020 7380 4313 or by email at jon.spence@elexon.co.uk.

Yours sincerely

Jon Spence
Market Advisor