



Electricity Distributors, Electricity Suppliers, Consumer Representatives and other interested parties

Promoting choice and value for all customers

Our Ref: SG&G/Distribution
Telephone: 020 7901 7194
Email: rachel.fletcher@ofgem.gov.uk

24 May 2011

Dear Colleague,

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

1. On 21 March 2011 we published an open letter consultation dealing with the interactions between the electricity distribution losses incentive scheme and GVC activity. This letter sets out the next steps in handling GVC adjustments; summarises the responses to our letter of 21 March and provides an overview of two further applications we have received.
2. The consultation process set out three response stages:
 - a. Any suggestions or comments on the proposed way forward as set out in the consultation letter were to be received by the end of March 2011.
 - b. Further adjustment applications by DNOs would be accepted if received before 15 April 2011 (provided they were supported by the necessary data), and would be considered outside of the DPCR4 Losses Rolling Retention Mechanism (LRRM). The effect on use of system charges of any decision on such applications would not apply before 1 April 2012 (the next annual charging revision).
 - c. We invited suggestions and comments regarding any improvements which could be made to the methodological approach to adjustment applications set out in the 17 December 2010 letter ("*the CE decision*" - *Decision on request from Northern Electric Distribution Ltd ('NEDL') and Yorkshire Electricity Distribution plc ('YEDL') for consent to calculate distribution losses for 2009-10 on a basis that differs from that used for 2002-03*), to reach us before 2 May 2011.
3. We received various responses to each of the three stages and these are summarised below. We also received applications for adjustments from Electricity North West (ENW) and SP Energy Networks (SP) within the timescales set out in our letter. The full responses (other than those deemed confidential) can be accessed on our website.

Overview of next steps

4. As a result of the various responses received, including the two additional applications, we have decided on the following process going forward:

- a. We will consider the ENW application (see paragraphs 11-14, 17-21) by the end of July 2011, and any revenue impact will be brought into the April 2012 charges. We have published their application and invite stakeholders to raise any specific issues and concerns with us by 10 June 2011.
- b. We will consult on the alternate approach suggested by the SP application (see paragraphs 22 – 25 below) and Engage Consulting Limited. The consultation will run between September and November 2011 and we will make a decision on their application by mid-January 2012. Any revenue impact will be brought into the April 2013 charges.
- c. If necessary, we will review the CE and ENW interim decisions after the consultation and decision on the SP methodology. Any changes will be incorporated into the DPCR4 LRRM close-out process during 2012, with the associated revenue impact brought into the April 2013 charges.
- d. We will take forward issues raised concerning general data transparency, suitability and availability through interaction with bodies such as the DCMF and Elexon.

Summary of responses

Views on the preferred approach

5. No substantial objections were expressed to our proposed way forward in terms of process, although some stakeholders raised issues of clarity.
6. In particular, suppliers requested clarity as to when any approved changes would be reflected in Distribution Use of System (DUoS) charges, and noted the need for early information regarding any additional applications received through this process.
7. Although stakeholders agreed with our proposed approach, some also highlighted the need for further consultation on the methodology and accuracy of the figures used in the adjustments.

Inputs to methodological approach used to correct for GVC distortions in DNOs' losses reporting

8. A number of comments were received from stakeholders (distributors, suppliers and industry consultants) regarding the methodology used in the CE decision. These included suggestions for improvements and further issues to be considered in any assessment of an application to restate reported losses. A number of issues related to process (information availability, consultation and timing of decisions) were also highlighted.
9. The following summarises some of the main comments raised on the methodological approach:
 - a. Concerns over the treatment of negative Estimated Annual Consumptions (EACs) in the methodology. Some stakeholders felt there was a potential risk of double counting of units corrected through the treatment of negative EACs, and corrections that occur through the settlements process.
The methodology used for CE specifically notes this issue, and the Authority's decision places an obligation on CE to ensure that double counting does not occur. We will consider this issue further in our consultation on the SP methodology.
 - b. Concerns on disregarding valid adjustments made through settlements processes (final and post-final settlement runs – RF and DF).
While this is a valid point, the RF/DF reconciliations for the 2009-10 data for CE were considered to be so badly contaminated that reaching a valid number

would be impossible. The conclusion was that nullification was preferable for the purpose of this exercise. ENW takes the same approach in their application. The alternate approach suggested by the SP methodology deals with this issue by proposing an alternate 'normalising' of the RF data.

- c. Some stakeholders raised issues regarding the asymmetry of corrections, for example that negative EAC adjustments were included but not positive ones. *The broader concerns to do with transparency, suitability and availability of data have been highlighted throughout the process. As noted above, we will take these issues forward through the DCMF and through interaction with Elexon.*
10. We will consider the comments made as we analyse the additional applications to restate 2009-10 losses data.

Overview of further applications received

11. In our consultation letter of 21 March 2011, we set out that we would review any DNO applications for adjustment to losses reporting relating to GVC that we received by 15 April 2011 and which were supported by the necessary data. We also set out that any decision arising from such a review would not apply to charges before April 2012.
12. We received additional applications for adjustment to the 2009-10 reported losses from two Distributors – ENW and SP. A redacted version of the ENW application is available on our website¹. We will make the SP application available on our website in due course.
13. In response to requests from stakeholders we have also published on our website a redacted version of the CE application which was approved in December 2010.
14. The ENW application proposes:
 - using a materially identical methodology to that used for the CE decision
 - making adjustments to distributed units totalling 316.6GWh, leading to an adjustment of £21.5m (which means changing the £17 million over-recovery in 2009/10 to a £4.5million under recovery)
 - making the necessary adjustment (if approved) to their DUoS charges with effect from April 2012.
15. The SP application (on behalf of SP Manweb plc and SP Distribution Ltd (SPD)) proposes:
 - using a somewhat different approach to that used for the CE decision, but based on the same principles and with reasons provided for the differences
 - making adjustments to their distributed units of 237 GWh (SP Manweb) and 362GWh (SP Distribution), leading to a revenue adjustment of £70m (SP Manweb) and £107m (SPD)
 - making the necessary adjustment (if approved) to their DUoS charges with effect from April 2012 (although SP has subsequently acknowledged that consultation on the methodology could delay this until a later period, such as April 2013).
16. Other Distributors noted that they were content for any adjustment to their 2009-10 reported losses to be processed as part of the DPCR4 LRRM close-out process, and would not submit applications for adjustment to their 2009-10 reported losses at this stage. This was despite noting that their initial investigations suggested that there had been abnormal GVC activity in many licensed distribution areas.

¹ <http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Pages/DPCR5.aspx>

ENW Application

17. The methodology used for the ENW application is materially the same as that used to reach the CE decision. Ofgem will consider the ENW application on its merits, taking account of the need (a) to apply a fair approach to all DNOs consistent with that applied to CE unless a different approach is justified, and (b) to honour our commitment to consider applications received by 15 April 2011 (provided they were supported by the necessary data), allowing any revenue adjustment to be effective from April 2012.
18. We are mindful of the representations from suppliers subsequent to the CE decision, requesting more advance notification of any pending decision on additional applications in future. To this end, we are planning to publish a decision before the end of July 2011 so that any revenue impact may be reflected in the April 2012 charges, allowing suppliers time to mitigate for associated risks.
19. As we have already received views on the methodology used in the CE decision, which closely mirrors that proposed by ENW, we do not propose to formally consult on the ENW application. At this stage, we are minded to make a decision on whether or not to allow an interim restatement under this methodology, with any such restatement to be subject to possible revision after consultation on the alternate methodology proposed by SP. Any interim restatement would be reflected in the April 2012 charges, but any later revision impacting on revenue would be deferred to April 2013 along with the DPCR4 LRRM close-out. Any such decisions will take account of the comments and suggestions received as part of the consultation on SP's proposed methodology.
20. As noted above, we have received a number of comments on the CE methodology, and will be consulting further on the alternative methodology proposed by SP. During our assessment of the ENW application we will bear in mind both these comments and any further remarks we receive by 10 June 2011. However, in the interests of uniformity of treatment we do not foresee any substantive departure from the approach taken for CE for the purposes of the ENW restatement.
21. Any inputs in this regard should reach us before 10 June 2011 and can be directed to Lesley Ferrando at the above address or e-mailed to Lesley.Ferrando@ofgem.gov.uk.

SP Application

22. The SP application states that their circumstances are the same as those affecting CE and that the proposed correction methodology is similar in principle as it normalises affected data with reference to earlier periods. However, the approach differs in certain aspects and SP believes that their methodology could lay the foundation for an industry-wide solution that could be applied by other DNOs similarly impacted. We feel the approach is sufficiently different to that approved for the CE decision as to warrant further consultation with stakeholders prior to any approval.
23. This consultative process would impact on the approval timelines, making it unlikely that a decision could be reached before the end of July 2011. In this case, any impact on revenue arising from a later approval would be deferred until April 2013.
24. SP (assisted by Engage Consulting Limited) believe that the methodology proposed represents a more practical solution to that applied by CE and ENW, and involves quantifying abnormal variations compared to SF settlement data and normalising the SF reference point. Further information on the methodology and the SP application will be made available to all stakeholders as soon as possible.
25. A consultation process to consider the methodology proposed by SP and Engage Consulting Limited, as well as other points of concern raised by stakeholders, will begin after the decision on the ENW application.

26. If you have any further comments or queries on any of the above matters please contact Lesley Ferrando at the above address or e-mail to Lesley.Ferrando@ofgem.gov.uk.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', written over a light grey rectangular background.

Rachel Fletcher
Director, Distribution