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Dear Lesley,


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

We recognise the potential impact that steps taken by suppliers can have on DNOs' performance under the losses incentive mechanism; Gross Volume Correction (GVC) activity taken by suppliers can have a particularly adverse effect on DNOs if it affects a number of years of data. As such, we understood Ofgem's decision in December last year to allow for an adjustment to CE Electric UK's reconciliation data for the purposes of its 2009/10 losses performance.

However, given suppliers' concerns, we note Ofgem's preferred way forward to address any further GVC activity through the DPCR4 losses rolling retention mechanism (LRRM). Whilst we are not opposed to this *per se*, we believe there are a number of areas that Ofgem will need to be mindful of.

The reporting of losses in DPCR5 is not necessarily on the same basis as DPCR4. It therefore does not automatically follow that a change made to reported losses for the purposes of the DPCR4 incentive will have the same impact on the DPCR5 incentive and LRRM. Ofgem's 'upfront' approach for CE Electric UK is more transparent: by applying the change at the point of reporting 2009/10 losses, this adjustment will feed into its 2009/10 losses performance under the DPCR4 incentive and then flow correctly into the DPCR5 incentive. However, it is less clear how the DPCR4 and DPCR5 mechanisms will interact under Ofgem's proposed way forward.

For example, if the GVC activity affects a DNO's DPCR4 reporting of losses, but the intention is to account for this through the LRRM, it is more difficult to see how the DPCR4 and DPCR5 impacts will reconcile. This is in part caused by the different reporting methodologies across DPCR4 and DPCR5, but also due to the inextricable link between 2009/10 performance, the fixed, flat DPCR5 target and the outcome under the LRRM.



There is also a concern that by flexing the LRRM to accommodate GVC activity, this distorts the DPCR5 incentive and scope for outperformance relative to DNOs that have no such adjustment.

Whilst not insurmountable, we believe these areas require careful consideration. However, we are more concerned by the proposal to deviate from the approach set out in your 17 December decision for CE Electric UK. This could be viewed as introducing *ex post* discrimination into the price control settlement and potentially set an unwelcome precedent. If Ofgem does not believe it can treat all future applications for an adjustment in response to GVC activity on the same basis as its 17 December decision, we believe it should consider revising this earlier decision to ensure that its methodology is non-discriminatory across all DNOs. We believe this approach is more in keeping and consistent with Ofgem's duties.

I hope this is useful input even at this stage. However, should you wish to discuss any of the above in more detail, please do not hesitate to contact me.

Yours sincerely,

Aileen McLeod
Head of Regulation, Networks