

Paul Bircham  
Regulation Director  
Electricity North West Ltd  
304 Bridgewater Place  
Birchwood Park  
Warrington  
Cheshire  
WA3 6XG

---

*Promoting choice and  
value for all customers*

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

29 July 2011

Dear Paul,

**Interim decision on request from Electricity North West Ltd (ENWL) for consent to calculate distribution losses for 2009-10 on a basis that differs from that used for 2002-03**

1. We have carefully considered the request contained in your e-mailed application received on 14 April 2011<sup>i</sup> and the appendices thereto<sup>1</sup>. Your request refers to three issues which have affected your reported numbers for units distributed for relevant year 2009-10:
  - (i) Gross Volume Correction<sup>2</sup> ('GVC') adjustments to settlements data by suppliers in your distribution services area ('DSA').
  - (ii) negative Estimated Annual Consumption ('EAC') values arising in settlements data in your DSA.
  - (iii) a technical change in your sourcing of input data which erroneously led to some Dispute Final (DF) reconciliation data being included in the units distributed total for 2009-10 which was inconsistent with the basis of reporting you used in 2002-03.
2. You have asked for approval to recalculate your distribution losses for 2009-10 using a methodological approach to address the issues referred to at points (i) and (ii) in paragraph 1. If approved you would restate your losses information for Regulatory Year 2009-10 and this would have a consequential effect on your current level of allowed revenue. Point (iii) above relates to a reporting error which can be resolved by referring to the appropriate settlement values in any restatement of your 2009-10 losses information.
3. We have considered your application bearing in mind the similar application received from the CE Electric UK group ('CE') on 12 November 2010<sup>ii</sup> and the 17 December 2010 decision of the Authority<sup>iii</sup> in that case ('the CE decision'). You state in your application that, as your approach to the reporting of units distributed is very similar to that used by CE, it is appropriate that the methodology used for CE is also applied for the correction of your data at this stage.

**Background to your request and your proposals to rectify the reporting position**

4. Following the CE decision, on 21 March 2011<sup>iv</sup> we consulted on the GVC methodology. In this consultation we set out our preference that any further adjustments to Distribution Network Operator (DNO) losses reporting for 2009-10 should be considered as part of the DPCR4 Losses Rolling Retention Mechanism (LRRM) process. However, we stated that applications received before 15 April 2011 and supported by the necessary data would be considered this year, whilst stipulating that any effect of such decisions on use of system changes should apply from no earlier than 1 April 2012. In addition, we stated that in considering any further applications we would take appropriate account of comments we received on the methodology set out in the CE decision.

---

<sup>1</sup> Reference documents and URLs for the Ofgem website are listed in footnotes to this letter

<sup>2</sup> An explanation of GVC is contained in Appendix 1 to this letter

5. We also advised that ahead of the LRRM process we would consult again on the final methodology we will apply to address the effects of GVC (and any similar sales data adjustments by electricity suppliers). We expect to be in a position, following that consultation, to determine the best methodological approach to deal with these issues which will allow us to reach decisions on any remaining restatement applications by DNOs and, as appropriate, review the basis of the interim decisions already taken.
6. On 24 May 2011 we published a letter<sup>v</sup> covering the responses received to our 21 March 2011 consultation. In this document we set out that, as a result of the various responses received and the restatement applications received from ENWL and Scottish Power (SP), we proposed to make an interim decision on your application by the end of July 2011. We also confirmed that we would consult on the alternate methodological approach proposed by SP, and that if, as a result, we adopted a different methodology we would review the CE and ENWL interim decisions as part of the LRRM process.

### GVC

7. In your application you set out evidence to show that for relevant year 2009-10, an abnormally high level of GVC adjustments affecting ENWL has led to a significant reduction in the number of units reportable as having been distributed through your network under the normal reporting methodologies. This reduction has significantly affected ENWL's performance under the distribution losses scheme for 2009-10.
8. You have proposed an approach to correct for the undue impact of GVC in 2009-10 based on adjustments to reconciliation levels attributable to settlement runs after the initial (SF) settlement run as follows:
  - (i) Reconciliation levels for runs 1, 2 and 3 to be 'normalised' to the average reconciliation level for the period from 2005-06 to 2008-09.
  - (ii) Reconciliation levels for the Final (RF) and Dispute (DF) runs to be set to zero.
9. This approach is intended to neutralise the abnormal GVC effect in 2009-10 whilst recognising that a background level of volatility exists in settlement data in any case, to which a 'normal' level of GVC could be expected to be a contributory factor. We note that you have obtained feedback from Elexon, the Balancing and Settlement Company, who have referred to abnormal trends in data observed during the 2009-10 period. They commented that there is anecdotal evidence that some suppliers were carrying out GVC activity ahead of a Balancing and Settlement Code rule change in February 2010.

### Negative EAC values

10. Your review of P222 information<sup>3</sup> from data aggregators highlighted a significant number of instances where meter points had erroneously been ascribed a negative estimated annual consumption figure. The level of GVC adjustments affecting data for 2009-10 is likely to have been a factor in the high incidence of negative EACs because of a characteristic of the settlement calculation system (which has since been amended to address the effect).
11. The negative EACs are likely to have caused a further material reduction in the number of units reportable as having been distributed through your network under your normal reporting methodology.
12. The following points were made in responses to our earlier consultation publications:
  - (i) some negative EACs shown in a P222 report might be over-written by Annual Advance figures generated by valid meter reads in which case they would not affect settlement totals;
  - (ii) some negative EAC values might have been excluded from settlement totals by data validation checks;
  - (iii) the approach ignores the possibility that erroneously large positive EAC values could be benefitting DNOs; and

---

<sup>3</sup> P222 information constitutes a quarterly 'snapshot' of EAC values for meter points

- (iv) P222 'snapshot' data is not sufficient either for ascertaining the level of negative EACs or monitoring their use in settlements.
13. We fully expect that these points will also be considered as part of the methodology consultation referred to in paragraphs 5 and 6 above. However, in considering our response to your application at this time, we consider it appropriate to take into account:
- (i) the need to avoid discrimination between DNOs as regards rights or obligations except where objectively justified;
  - (ii) the similar timing and circumstances of your representations on this issue as compared to those which gave rise to the CE decision;
  - (iii) the safeguards against the double counting of negative EAC values included in the CE decision methodology;
  - (iv) the absence of a better, established method to correct distortion at this time; and
  - (v) the explicitly interim nature of any decision taken by us at this juncture.
14. You have proposed that the negative EAC values in 2009-10 settlements data should be replaced with profile average values for the profile class concerned. This is broadly consistent with the approach which will be used in the settlements system itself going forward. Your analysis of the total effect of the negative MPANs is based on an extrapolation of P222 information available from settlement data aggregators.
15. You have confirmed that you will monitor ongoing settlements data for any units relating to advances of the subject meters until the benefit of the methodological adjustments referred to above have been 'used up'. This will address the risk that units might be double counted as valid meter readings enter the settlement system going forward. You propose that any units identified that need to be discounted from future reporting will be taken into account when calculating the LRRM Close-out.

#### Reporting Correction in relation to DF reconciliations

16. You have recently identified that your 2009-10 calculation of losses erroneously included DF reconciliations which was not consistent with your 2002-03 methodology or reporting in preceding Regulatory Years during the DPCR4 price control period, which were based on RF reconciliation data. It was therefore incorrect to include them in your original calculation, and you propose that they be removed from your 2009-10 figures through the restatement. This results in your 2009-10 units distributed being increased and reported losses commensurately reduced.

#### **Factors considered by the Authority**

17. In considering your proposals we have taken a number of factors into consideration. These are set out in Appendix 2 to this letter.

#### **The Authority's decision on ENWL's proposals**

18. We note that you first made representations concerning the GVC issue and its effect on losses reporting in May 2010 and have kept us apprised of subsequent developments. Your request, in August 2010, for relief from the penalty rate of interest associated with over-recoveries of allowed revenue on the basis that GVC activity may have distorted losses reporting was the subject of our consultation letter (Ref 87/10) dated 20 July 2010<sup>vi</sup> and decision letter dated 14 December 2010<sup>vii</sup>.
19. We consider that your submission, together with information we have received from Elexon and electricity suppliers, shows that there has been a material change in the quality of the information used to derive distribution losses information for ENWL in 2009-10 and that the proposed adjustments are necessary at this time. The Authority therefore agrees to the restatement of losses information for 2009-10 by ENWL on a revised basis in accordance with paragraphs 21 to 26 below, and subject to the stipulations and caveats set out.
20. We note that the independent auditor for ENWL has indicated that if ENWL's proposals are accepted by the Authority, it will be appropriate for 2009-10 revenue reporting returns to be restated accordingly.

## GVC

21. The Authority's decision on this matter is that, for the purposes of a restatement of the losses information in your 2009-10 revenue return, you should adjust the reported number of units distributed in 2009-10 in accordance with the proposed approach summarised in paragraph 8 above such that the reported number of units distributed in 2009-10 is increased by 228.2 GWh<sup>4</sup>.
22. You must report any factor which comes to your attention after implementation of this decision which impinges on the basis for the decision or suggests that further adjustments in respect of the GVC issue might be necessary or appropriate.

## Negative EAC values

23. The Authority's decision on this matter is that, for the purposes of a restatement of the losses information in your 2009-10 revenue return, you should adjust the reported number of units distributed in 2009-10 in accordance with the proposed approach summarised in paragraph 14 above such that the reported numbers of units distributed in 2009-10 is increased by 52.3 GWh.
24. You must also carry out the monitoring/unit discounting action referred to in paragraph 15, keeping appropriate records and advising Ofgem of any difficulty in achieving the requirement. In addition you must report any factor which comes to your attention after implementation of this decision which impinges on the basis for the decision or suggests that further adjustments in respect of the negative EAC issue might be necessary or appropriate. We note that your review of the P222 information for May 2011 shows a reduction in the number of negative EACs, and gives an initial indication that these figures might need to be revised. As the values involved are not yet certain, we are not able to take them into account at this stage. However, you will be in a position to refine these figures after examining the P222 information received in August 2011, and we will refer to any updated figures in the LRRM review as appropriate in the light of the methodological approach we apply at that point.
25. We acknowledge that some suppliers have raised objections to the treatment of negative EACs in the CE decision, and expressed concern with the similar approach you have proposed. We are cognisant of the limitations of the approach but consider in the circumstances (including those mentioned in paragraph 13) that it is appropriate to approve your proposed treatment on an interim basis at this time.

## Reporting Correction

26. We agree that it is appropriate to adjust ENWL's 2009-10 figure for units distributed to reflect the incorrect inclusion of DF reconciliations. Therefore the Authority's decision on this matter is that the reported number of units distributed for 2009-10 should be increased by 36.1GWh in this respect.

## Effects on losses incentive earnings and allowed revenue for 2009-10

27. The approximate affect on ENWL's revenue reporting for 2009-10 is expected to be as set out below, subject to the exact allocation of units between distribution unit categories, which affects the revenue driver calculation:

£m	ENWL before restatement	ENWL after restatement
Losses incentive adjustment	-18.35	0.67
Allowed demand revenue	253.71	274.59

## Impact on use of system charges

28. In accordance with paragraph 4 of our letter published on 24 May 2011 and paragraph 1.7 of your request, any changes to your use of system charges to reflect the incremental change in allowed revenue resulting from the restatement approved by this letter should not take place

<sup>4</sup> Figure stated in paragraph 5.3 of the ENWL application. (Paragraph 3.27 and Appendix D show 264.2GWh, which is made up of the 228.2GWh GVC effect plus the 36.1GWh reporting error).

before April 2012 and should be reflected in any notice of proposed amendments to use of system charges required by Standard Condition 14.11 of ENWL's Electricity Distribution Licence.

## Next steps

29. You should submit a restated revenue reporting return for ENWL for 2009-10 as soon as possible reflecting the decisions set out above, together with an opinion from the independent auditor concerning the appropriateness of the restated returns.
30. As set out in paragraphs 5 and 6, we will consult ahead of the LRRM process on the final methodology we will apply to address the effects of GVC (and any similar sales data adjustments by electricity suppliers). This consultation will include a review of the approach to deal with negative EACs. The methodological approach determined through this consultation will allow us to reach decisions on any remaining restatement applications by DNOs and, as appropriate, review the interim decisions already taken on CE and ENWL.
31. All DNOs will be required to provide updated losses information for the DPCR4 period during 2011-12 to facilitate the calculation of LRRM and allowed loss percentage values. In determining these values for ENWL we will take into account the conclusion reached on our forthcoming consultation on the methodology (mentioned above). Our decisions set out in this letter are therefore explicitly subject to further adjustments in that regard should they prove necessary or appropriate.
32. Any queries regarding the content of this letter should be sent for the attention of Lesley Ferrando, Senior Manager, Policy Analysis or emailed to: [lesley.ferrando@ofgem.gov.uk](mailto:lesley.ferrando@ofgem.gov.uk).

Yours sincerely,



**Rachel Fletcher**  
**Partner, Distribution**  
**Signed on behalf of the Authority and authorised for that purpose**

---

<sup>i</sup> ENWL Losses restatement application dated 14 April 2011  
<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Losses%20Submission%20140411.pdf>

<sup>ii</sup> CE Electric losses restatement application dated 12 November 2010  
[http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/CE\\_Losses\\_Request\\_Final\\_12Nov1020May11.pdf](http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/CE_Losses_Request_Final_12Nov1020May11.pdf)

<sup>iii</sup> 17 December 2010 Authority decision on CE application  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=56&refer=Networks/ElecDist/Policy>

<sup>iv</sup> 21 March 2011 Consultation on the way forward in dealing with the interaction between the electricity distribution losses incentive scheme and Gross Volume Correction (GVC) activity (ref 35/11)  
[http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Open\\_Letter\\_GVC\\_impact\\_on\\_DNO\\_losses\\_incentive\\_Mar\\_11\\_Final.pdf&refer=Networks/ElecDist/PriceCtrls/DPCR5](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Open_Letter_GVC_impact_on_DNO_losses_incentive_Mar_11_Final.pdf&refer=Networks/ElecDist/PriceCtrls/DPCR5)

<sup>v</sup> 24 May 2011 Information on responses to consultation on the way forward in dealing with the interactions between the electricity distribution losses incentive scheme and Gross Volume Correction (GVC) activity  
<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Responses%20to%20March%20consultation%20on%20GVC%20impact.pdf>

<sup>vi</sup> Consultation on implications of gross volume corrections for DNO revenues (ref 87/10)  
<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/Consultation%20on%20implications%20of%20gross%20volume%20corrections%20for%20DNO%20revenues.pdf>

<sup>vii</sup> Authority decision on relief from the consequences of over-recovery of allowed revenue caused by Gross Volume Corrections (GVCs) in settlement data  
<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/Decision%20on%20interest%20rate%20adjustments.pdf>

## Appendix 1

### **Explanation of Gross Volume Correction (GVC)**

GVC has been used by some electricity suppliers to make aggregate unit sales deductions from recent settlement periods to address long run volume overstatements attributable to them and identified in settlement data review exercises. Whilst the overstatement values concerned might have accrued over a prolonged period, the GVC adjustment would deduct the entire amount claimed by the supplier in a single period. This would have the indirect effect of distorting the apparent performance of the DNO, since the GVC adjustment would serve to depress the reportable number of units distributed for the period in which it was executed. The effects of GVC have varied between DSAs, reflecting the geographical market shares of the suppliers who have been most active in pursuing this type of billing rectification programme. Whilst GVC is most commonly used for this purpose, other techniques such as 'dummy meter exchanges' have also been used by some suppliers.

**Factors considered by the Authority in making an interim decision on request from Electricity North West Ltd (ENWL) for consent to calculate distribution losses for 2009-10 on a basis that differs from that used for 2002-03**

1. In considering your proposals we have been cognisant of the purpose of the losses incentive scheme in DPCR4<sup>5</sup> which was to apply an incentive adjustment to DNOs (reward or penalty) to reflect their performance in respect of distribution losses. We have considered this application in light of the decision made on the CE application. We have also considered three key principles relevant to the operation of the losses incentive scheme. Those are that there should be:
  - (i) Like for like target setting and performance monitoring - the basis used to set the benchmark level of losses for a DNO should be sufficiently equivalent to the basis used to calculate the out-turn loss levels which are compared to that benchmark.
  - (ii) Sufficiently accurate data - the data used to set the target and measure out-turn performance should be sufficiently accurate.
  - (iii) Even handed treatment as between licensees - the approach to setting benchmark losses and measuring performance should be 'even handed' as between different DNOs with any differences in treatment being objectively justified.
2. Losses reporting for relevant year 2009-10 is governed by Special Condition C1 of the electricity distribution licence which was in effect at the time ('the condition'). The condition incorporated two provisions which are pertinent to ENWL's application. Firstly, under paragraph 7 of the condition, in specified circumstances the Authority could direct a change to the DNO's allowed loss percentage ('ALP') where there had been a material change in the quality of the information used to derive system entry volumes or the numbers of units distributed. Secondly, whereas paragraph 9 of the condition stipulates that the DNO must normally stick to the losses reporting methodology it used in a reference year (2002-03), it also provides for the Authority to agree to a different basis for calculating the level of losses from the DNO's network.

The distribution losses incentive scheme in DPCR5

3. Each DNO's reported losses information for 2009-10 is used to ascertain its losses incentive adjustment for that year but it is also important for two reasons relating to the losses incentive scheme for the DPCR5 price control period<sup>6</sup>:
  - (i) Performance in 2009-10 is pivotal to the calculation of the adjustment which will be made under the LRRM which is explained in chapter 4 of the DPCR5 Final Proposals – Financial methodologies document<sup>7</sup>.
  - (ii) The reported loss rate for 2009-10 will be included in the calculation of ALPs for DPCR5.
4. Each DNO will be required to provide updated losses information for the DPCR4 period in due course to facilitate the calculation of LRRM and ALP values. This will provide an opportunity to make such further adjustments to the 2009-10 losses data for ENWL as become appropriate after we have carried out our proposed consultation on the methodology referred to in paragraphs 5,6 and 30 of the letter.

---

<sup>5</sup> The DPCR4 price control period ran from 1 April 2005 to 31 March 2010

<sup>6</sup> The current price control for DNOs (DPCR5) runs from 1 April 2010 to 31 March 2015

<sup>7</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=372&refer=Networks/ElecDist/PriceCtrls/DPCR5>

5. In considering your request, we have been mindful of the representations you have made since May 2010, the interim nature of the decision which we will make at this stage and the comparability of the circumstances you have set out to those considered in reaching the CE decision. We have also taken into account feedback received from stakeholders since our publication of the CE decision and responses to the consultation letters we have published. In particular we have considered:
  - the need for suppliers to have as much notice as possible of significant changes to allowed revenue/charging levels
  - possible weaknesses in the proposed restatement methodology and the consultation we have announced on possible alternative approaches
  - the limitations of data used to make adjustments in respect of negative EACs
6. As mentioned above, we will be carrying out a consultation on the best approach to dealing with the GVC issue as part of the DPCR4 losses incentive close out process and we will publish as much material pertaining to the consultation as possible. We will also work with industry groups in this respect and encourage any appropriate development of the revenue forecasting provisions contained in the Distribution Connection and Use of System Agreement (DCUSA).