

Consultation on regulatory measures to address the effects of gross volume correction and other settlements data adjustments on the distribution losses incentive mechanism

Consultation

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Overview:

Electricity distributors (DNOs) are incentivised to manage the amount of electricity lost across their networks, through the losses incentive mechanism which relies on data from the balancing and settlements system.

In 2010 certain DNOs raised concerns regarding significant adjustments to 2009-10 settlements data which distorted their apparent losses performance.

We have published interim decisions on adjustments to the reported losses for three DNOs. We are now consulting on a final methodology that can be applied to rectify the reported losses for any DNO that can demonstrate that a significant level of settlements data adjustment has distorted their losses performance in 2009-10. This will impact on the losses rolling retention mechanism and the determination of the losses targets for the current price control period. We are therefore also consulting on proposed changes to the current mechanism.

Context

Electricity distribution networks carry electricity from the transmission systems and some generators to industrial, commercial and domestic users. There are 14 licensed distribution network operators (DNOs) in Great Britain (GB) and six independent network operators. The DNO businesses are natural monopolies and Ofgem protects consumers' interests by independently regulating GB distribution activity. As part of our role we have a suite of incentives that are designed to encourage DNOs to improve performance, and we regulate the charges customers pay through periodic price controls.

Electricity losses from the distribution networks are a significant source of greenhouse gas (GHG) emissions representing approximately 1.5 per cent of total GB GHG emissions.¹ As part of the price control we incentivise the DNOs to reduce these losses. Distribution losses are calculated as the difference between the volume of electricity entering the distribution network, and volume exiting for consumption.

The data used to calculate losses can be affected by changes to the number of units recorded by the balancing and settlements system as having been consumed. In regulatory year 2009-10 some abnormally high levels of reconciliations to settlements data by suppliers were observed (reducing the reported totals for units consumed), which significantly affected some DNOs' reported loss levels.

In this consultation we explain the nature and magnitude of the data problem and seek views on options to deal with the data concerns.

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<http://www.ofgem.gov.uk/Media/FactSheets/Documents1/SD%20and%20Electricity%20Distribution%20Factsheet.pdf>

Associated documents

- Consultation on implications of gross volume corrections for DNO revenues; 20 July, 2010 (Ref 87/10)
<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/Consultation%20on%20implications%20of%20gross%20volume%20corrections%20for%20DNO%20revenues.pdf>
- Authority decision on relief from the consequences of over-recovery of allowed revenue caused by Gross Volume Corrections (GVCs) in settlement data; 14 December, 2010
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=54&refer=Networks/ElecDist/Policy>
- Decision on request from CE Electric UK for consent to restate losses information for 2009-10; 17 December, 2010
<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/Decision%20on%20request%20from%20CE%20Electric%20UK%20to%20restate%20losses%20for%202009-10.pdf>
- Open letter: Consultation on the way forward in dealing with the interactions between the electricity distribution losses incentive scheme and Gross Volume Correction (GVC) activity; 21 March, 2011 (Ref 35/11)
<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Open Letter GVC impact on DNO losses incentive Mar11 Final.pdf>
- 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; 24 May, 2011 (Ref 70/11)
 - a. Scottish Power losses restatement submission
 - b. Scottish Power Methodology paper by Engage Consulting
 - c. CE Electric UK losses restatement application
 - d. ENW losses restatement application<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=555&refer=Networks/ElecDist/PriceCtrls/DPCR5>
- 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; 29 July, 2011
<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/Interim%20decision%20on%20request%20from%20ENWL%20to%20restate%20losses%20for%202009-10.pdf>
- Electricity Distribution Price Control Review Final Proposals – Incentives and Obligations; 7 December, 2009 (Ref 145/09)
http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/FP_2_Incentives%20and%20Obligations%20FINAL.pdf
- Electricity Distribution Price Control Review Final Proposals – Financial Methodologies; 7 December, 2009 (Ref 148/09)
http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/FP_6_DPCR5%20Financial%20methodologies.pdf
- DPCR4 Electricity Distribution Price Control Review - Final Proposals; 28 November, 2004 (Ref 265/04)
<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR4/Documents1/8944-26504.pdf>

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Executive Summary

This consultation arises from some DNOs noting a high level of abnormal settlement data adjustments in 2009-10 which increased their incentivised losses for that year. This not only affects the amount of losses incentive (reward or penalty) they experience in that year, but also affects the calculation of the close out position for the previous price control period and the target losses going forward.

Three of the DNO groups have applied to revise the way they reported losses in order to remove these abnormal adjustments. Two (CE Electric UK (CE) and Electricity North West Limited (ENWL)) used a similar methodology to recalculate their losses, while Scottish Power (SP) has proposed an alternative method. Other DNOs have indicated that they may seek to re-report their 2009-10 losses following this consultation.

We consider that, on balance, the methodology proposed by CE should be used for all DNOs that can provide evidence that their losses have been materially affected by abnormal settlement data adjustments. We are consulting on the relative strengths and weaknesses of the two methodologies, as well as the appropriateness of using a standardised approach for all DNOs.

This consultation also sets out how we propose to close out the last price control (DPCR4), taking account of any abnormal settlement data in the calculation of the losses rolling retention mechanism (LRRM). We also consult on our view that abnormal settlement adjustments should not be removed from the data used to calculate the targets for the current price control, DPCR5.

We are organising a stakeholder workshop during the consultation period to discuss any issues of clarity or matters arising from the consultation. All network operators will also be expected to complete the estimated outcomes questionnaire (Appendix 4) to allow comparison of the impact of applying the different methodologies.

Based on the decision made on the methodology, we will make a decision on the application by SP, and if necessary review the CE and ENWL interim decisions (discussed in more detail in Chapter two), taking into account any updated information available.

We will proceed with the calculation of the DPCR4 LRRM and the DPCR5 targets, both of which are required to be finalised before 30 November 2012. As part of the LRRM process we will also process any further applications received from DNOs to restate 2009-10 losses for the purposes of calculating the LRRM and DPCR5 targets which are supported by the necessary data.

In making our decisions, we will consider the likely timing of revenue impacts and the need to provide suppliers and their consumers with sufficient notice before any changes to distribution Use of System (UoS) tariffs take effect.

1. Introduction

Chapter Summary

This chapter describes the losses incentive mechanism and how it has been affected by atypically high reconciliation adjustments to settlement data for 2009-10. It sets out the related decisions leading up to this consultation process.

Background

Electricity Distribution Losses Incentive Mechanism

1.1. Ofgem introduced a losses incentive mechanism in the third electricity distribution price control (DPCR3) to provide a financial incentive (reward or penalty) to encourage the DNOs to manage the level of losses on their networks. Losses can be reduced by making appropriate investments on distribution networks, optimising network operation, influencing users, working with third parties to improve the quality of data and reducing theft.

1.2. In the following price control period (DPCR4)² the losses incentive mechanism was kept relatively simple, much like the mechanism first introduced. The losses mechanism allowed DNOs some flexibility in choosing the methodology by which they would report on losses performance, including the use of provision accounts or trend analysis adjustments to settlements data. The primary requirements were for reporting integrity and consistency of reporting over time. Companies were therefore required to seek approval from Ofgem before changing the way they reported losses.³

1.3. In the most recent price control (DPCR5) we concluded that DNOs needed to report their losses using a common methodology based on settlements data, and that losses should be reported with a lag of two years to reduce the volatility arising from settlement corrections. Further details of the DPCR5 Losses Incentive can be found in the DPCR5 Final Proposals⁴ and the Electricity Distribution Price Control Cost

² The DPCR4 price control period ran from 1 April 2005 to 31 March 2010

³ The details of the DPCR4 losses incentive mechanism are set out in DPCR4 Final Proposals <http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR4/Documents1/8944-26504.pdf> and special licence condition C1 of the electricity licence in force during DPCR4 <http://epr.ofgem.gov.uk/index.php?pk=doc188957>

⁴ Chapter 6 of 'Final Proposals – Incentives and Obligations' http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP_2_Incentives%20and%20Obligations%20FINAL.pdf) and Chapter 4 of 'Final Proposals – Financial Methodologies'

and Revenue Reporting Regulatory Instructions and Guidance: Version 2.⁵ The mechanism is governed by Charge Restriction Condition (CRC) 7 (Adjustment of licensee's revenue to reflect distribution losses performance) of the electricity distribution licence.

1.4. The losses incentive mechanism is conceptually simple and has proved an effective method of encouraging the DNOs to achieve an efficient level of losses on their distribution network. A DNO's losses are calculated by deducting the number of units distributed from the number of units entering the network. In each price control we set each DNO a target for losses as an annual allowed losses percentage (ALP) for the price control period, based on that DNO's past performance. If a DNO's percentage losses exceed the ALP then they receive a penalty, and if their losses percentage is lower than the ALP then they receive a reward. The size of the penalty/reward is dependent on the number of megawatt hours (MWh) achieved above or below the target level. In DPCR4 the incentive rate was set to reflect the wholesale value of electricity (£48/MWh pre-tax, indexed for RPI inflation). In DPCR5 this value is set at £60/MWh pre-tax (indexed for RPI inflation) which reflects the approximate wholesale value of electricity and the cost of carbon.

1.5. The number of units entering the distribution system is measured using meters at the system entry points (ie grid supply points (GSPs), interconnector and embedded generation sites). The number of units distributed, is derived from settlement data. Settlement data is primarily used in the wholesale trading market and by National Grid to inform system balancing mechanisms⁶ and uses a mixture of estimated and metered data.

1.6. The losses incentive in DPCR4 also included a rolling retention mechanism to encourage loss reduction initiatives to be undertaken at any time in the price control period by guaranteeing rewards (or penalties) for a full five year period. In our DPCR5 Final Proposals⁷ (Final Proposals) we set out how we would apply the LRRM in closing out DPCR4, and also that we would retain the LRRM for DPCR5. The methodology we set out to close out the DPCR4 losses incentive should ensure that there are no windfall gains or penalties to the DNO arising from settlements data corrections and provision accounting, the DPCR5 change to reporting methodologies, and the setting of new targets for DPCR5.

(http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP_6_DPCR5%20Financial%20methodologies.pdfhttp://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP_6_DPCR5%20Financial%20methodologies.pdf)

⁵http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/Cost_and_revenue_reporting_RIGs.pdf

⁶ Further detail on settlements data is provided in Chapter 2 of this document – settlements data adjustments and their impact

⁷ Further detail can be found in Chapter 6 of 'Final Proposals – Incentives and Obligations'

Settlement data corrections

1.7. In 2010 a number of DNOs noted high levels of data reconciliation adjustments arising from unconventional Gross Volume Correction (GVC) and other data cleansing activity by suppliers.⁸ These adjustments affected DNOs' 2009-10 reported losses and therefore some DNOs applied for relief from the consequences of over-recovery of their 2009-10 revenue allowance since their apparent actual losses incentive performance had not been reflected in their charges to customers.


1.8. One of the companies, CE Electric UK (Northern Electric Distribution Ltd (NEDL) and Yorkshire Electricity Distribution plc (YEDL)), also requested consent to revise their losses reporting methodology in order to remove these unconventional adjustments, in accordance with the DPCR4 licence which was in force for the 2009-10 regulatory year. This application was approved by the Authority.⁹ In March 2011 we published an open letter consultation on the way forward in dealing with the interactions between the electricity distribution losses incentive scheme and GVC activity.¹⁰ This letter stated that our preference was to consider any further adjustments to DNO losses reporting with respect to GVC adjustments as part of the LRRM process to be undertaken in 2012. However we agreed to review any DNO applications received by 15 April 2011 (supported by the necessary data) in advance of the LRRM. We also stated that ahead of the LRRM process we would consult on the methodology we would apply, if there was sufficient (or updated) evidence of unconventional GVC (or other similar sales data adjustments by electricity suppliers) which impact on a DNO's settlement data.

1.9. In response we received applications from three other DNOs (ENWL, SP Manweb and SP Distribution) to revise their losses reporting methodology for 2009-10. ENWL proposed to use the same methodology as CE, whilst SP has proposed a different method. The remaining DNOs indicated that they would consider submitting applications at a later stage of the process.

⁸ A level of reconciliation adjustments is normal and reflects meter readings which come in over a fourteen month period

⁹<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/Decision%20on%20request%20from%20CE%20Electric%20UK%20to%20restate%20losses%20for%202009-10.pdf>

¹⁰ Further details can be found in Open letter: 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/Open_Letter_GVC_impact_on_DNO_losses_incentive_Mar11_Final.pdf



Consultation on regulatory measures to address the effects of gross volume correction and other settlements data adjustments on the distribution losses incentive mechanism

1.10. There are three key legal principles that underpin the consideration of any adjustments to the reported losses data used for the losses incentive:

- **Like for like target setting and performance monitoring.** For each DNO, the basis used to set the ALP should be sufficiently aligned to the basis used to calculate the actual percentage electricity lost on the distribution network
- **Sufficiently accurate data.** The data used to set the ALP and the percentage electricity lost should be sufficiently accurate
- **An 'even handed' treatment of licences.** The approach used to set targets and measure performance should be even handed between licensees, with any differences in approach being objectively justified.

1.11. We have stated that as part of the LRRM process, we will review the decisions made on CE and ENWL based on the outcomes of this consultation, and if any further evidence has come to light. We will also issue a decision on the SP application and review any other applications from the remaining DNOs where there is sufficient evidence and justification.

2. Settlement data adjustments and their impact

Chapter Summary

This chapter gives an overview of the type of settlements data adjustments which have affected losses calculations, and sets out in more detail the process undertaken to date to address these issues.

Question box

Question 1: Do you think we have identified the main data/billing adjustment techniques used by electricity suppliers and their impacts?

Question 2: Are there any other factors you think we should take into consideration in assessing the impact of settlement data volatility?

Adjustments to settlement data in 2009-10

Settlements data

2.1. As stated previously, the volume of electricity exiting the DNO networks is calculated using settlement data. The rules governing settlement data are held within the Balancing and Settlement Code (BSC).¹¹ The electricity recorded in settlements on a particular day (Settlement Day) can subsequently be adjusted according to a set of rules. The four reconciliation runs (R1, R2, R3 and RF) provide a progressively more accurate picture of settlement data at sequential dates after the settlement date. If any volumes at RF are still under dispute then another run (DF) may be carried out when the corrected data has been received. The BSC Trading Disputes Committee decides whether or not the run takes place. The different settlement runs occur as illustrated in Table 1 below.

¹¹ A full description of the settlement process can be obtained from reference to the Elexon website: www.elexon.co.uk

Table 1: Settlement Run Calendar

Settlement Run Types	Approximate Period after Settlement Day
Initial Settlement – SF	17 Working Days
First Reconciliation – R1	2 Months
Second Reconciliation – R2	4 Months
Third Reconciliation – R3	7 Months
Final Reconciliation – RF	14 Months
Dispute Final - DF	Up to 28 months

2.2. Within the BSC there are processes which allow suppliers to make changes to settlement data under certain circumstances. These processes are intended to ensure that the gross volume of electricity reported to have been distributed is accurate, although at times it may be reflected in a different period.

2.3. Suppliers process data corrections through a number of mechanisms. The timing of any adjustments, and approaches used, may differ significantly between suppliers. DNOs have no visibility of the adjustments made and only observe the impact through settlement reconciliation data.

2.4. Historically the number of units recorded as distributed has been subject to a background level of volatility caused by the adjustments to settlement data, although the volatility has tended to reduce in the later reconciliation runs. In response to DNO concerns, the two year reporting lag was introduced in DPCR5 to minimise volatility.

2.5. In mid-2010, several DNOs contacted Ofgem with concerns that abnormally high levels of adjustments to settlement data had distorted the reported number of units distributed in 2009-10. Current evidence suggests that during 2009-10 some suppliers embarked on data cleansing/billing correction exercises and made a large number of aggregate corrections to settlement data. Two mechanisms were specifically identified as having been used for many of the corrections: Gross Volume Correction and Dummy Meter Exchanges.

Gross Volume Correction (GVC)

2.6. GVC is properly used in the settlement process as a last resort method of correcting annualised meter data and estimated annual consumption levels where erroneous values have affected settlement days whose final reconciliation has passed. However, GVC has also 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. While the overstatement values concerned might have accrued over a prolonged period, the GVC adjustment deducts the entire amount claimed by the supplier in a single period. This has the indirect effect of distorting the apparent losses performance of the DNO, since the GVC adjustment depresses the reportable number of units distributed for the period in which it was executed meaning that the DNO reports a one off significant increase in losses. Whilst initial evidence suggested that these adjustments may have arisen from errors dating back a significant period of time, we now understand that the 2009-10 adjustments, in the main, only reflected errors in recent years.

2.7. The effects of GVC have varied between distribution supply areas, reflecting the geographical market shares of the suppliers who have been most active in pursuing this type of billing rectification programme. These corrections had a significant effect in the 2009-10 regulatory year.

2.8. Changes to the Balancing and Settlement Code (BSC) which became effective from March 2010 may have prompted suppliers to accelerate their use of GVC for billing adjustments, as they limited the use of GVC to the correction of meter advance periods which span the latest reconciliation run date. Despite the rule change, concerns with the way in which GVC has continued to be applied have given rise to a current proposal (P274)¹² to modify the BSC and remove the GVC mechanism.

Dummy Meter Exchange (DMX)

2.9. Another method of correcting meter data involves 'Dummy Meter Exchanges' (DMXs). This technique is used for meters with poor historic meter readings to minimise previous meter reading errors (but not compensate for them) and provide a correct meter reading going forward. Under a dummy meter exchange, the meter is not physically replaced, but the supplier artificially creates a Final and Initial Reading within the settlement data to simulate a meter exchange.

2.10. This process has the effect of distorting the apparent losses performance of a DNO by inserting a step change in units measured through the meter.

Other systematic settlements data rectification

2.11. Suppliers have confirmed through industry interactions on this issue that they have undertaken a significant amount of other settlements data rectification action reflecting their increased attention to ensuring more accurate data. This has also contributed to the level of data volatility noted in the 2009-10 reported losses.

¹² Copy of P274 available on <http://www.elexon.co.uk/pages/modproposals.aspx>

Estimated Annual Consumption (EAC)

2.12. Many electricity meters are only read between every six months and a year. When they are read, the difference ('advance') between the current reading and the previous reading is determined. The advance is annualised and an Annualised Advance (AA) is determined using seasonality profiles ('profile co-efficient').¹³ Whenever an AA is calculated, an annualised estimate of future consumption is also calculated. This Estimated Annual Consumption (EAC) is determined from the AA and the previous EAC. This has the effect of 'smoothing' changes to EACs. EACs are replaced with AAs when the meter is read subsequently. Due to the time lapse, EACs are often determined from a different set of profile coefficients than the AAs that replace them.

2.13. In certain circumstances, for example where an updated meter reading is captured for a meter point where no meter readings have been recorded for some time and an AA has been applied, a situation can arise where meter points are erroneously given a negative EAC going forward. The high incidence of GVC (and other) adjustments affecting data for 2009-10 is likely to have driven up the level of negative EACs because of a characteristic of the settlement calculation system (which has since been amended to address the effect). Large negative EACs will significantly distort data going forward, and create a step change when corrected.

Consultation and decisions to date

Relief from over-recovery of allowed revenue

2.14. DNOs are required to take appropriate actions to ensure that the revenue they recover from customers does not exceed their allowed revenue.¹⁴ When a DNO's actual revenue exceeds 103 per cent of their allowed revenue, the over-recovery is subject to a penalty interest rate.¹⁵ This penalises DNOs by increasing the amount of money which is to be deducted from the following year's allowed revenue.

2.15. In 2010 Ofgem received applications from CE (NEDL and YEDL); ENWL and Eastern Power Networks plc (formerly EDF Energy Networks (EPN) plc) requesting exceptional relief from the consequences of over-recovery of allowed revenue. The basis for these applications was that abnormally high levels of unconventional

¹³ For further detail on the process of determining AAs (including an explanation on profile coefficients) refer to the Elexon website or alternately to paragraph 4.2 of the Engage Consulting submission in

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=555&refer=Networks/ElecDist/PriceCtrls/DPCR5>

¹⁴ Under Charge Restriction Condition 3.2 of the distribution licence – see <http://epr.ofgem.gov.uk/index.php?pk=doc188957>

¹⁵ Charge Restriction Condition 14.2

settlement adjustments had artificially reduced DNO performance in the Losses Incentive scheme causing an unforeseen reduction in their allowed revenue.

2.16. The Authority agreed that the reported losses for these DNOs in 2009-10 were abnormally high as a result of unconventional settlement data adjustments, were unrelated to network performance, were outside of DNO control and would not have arisen if these adjustments had not occurred. The Authority therefore felt it was appropriate to grant these DNOs relief from the application of the penalty rate of interest and the effect of over-recovery on future tariffs.¹⁶

Basis for restatement of 2009-10 reported losses

2.17. As part of DPCR4, the losses reporting for 2009-10 was governed by Special Condition C1 of the Electricity Distribution Licence.¹⁷ This condition stipulated that the DNO must retain the losses reporting methodology it used in a reference year (2002-03), but also provided for the Authority to agree to the DNO using a different basis for calculating the level of losses.

CE application

2.18. In November 2010 CE submitted an application to calculate the distribution losses for 2009-10 for both of their distribution network areas on a basis that differed from their existing methodology.

2.19. In their application CE satisfied the Authority that there had been a material change in the quality of data used to determine the level of distribution losses. The Authority therefore decided that it was appropriate for CE to resubmit their 2009-2010 losses return using their proposed methodology.¹⁸ CE's new methodology attempted to remove the impact of supplier billing corrections from the losses data, and is explained in more detail in the following chapter.

Progress following the CE decision

2.20. Following the CE decision, several other DNOs also approached Ofgem with requests to calculate their losses performance on a basis different to that used for 2002-03, due to high levels of unconventional adjustments to settlement data.

¹⁶<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=54&refer=Networks/ElecDist/Policy>

¹⁷<http://epr.ofgem.gov.uk/index.php?pk=doc188957>

¹⁸<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=56&refer=Networks/ElecDist/Policy>

2.21. In dealing with these further loss restatement calculations, Ofgem wanted to allow suppliers and their customers as much notice as possible about the possible impact on UoS charges. We therefore outlined that our preferred method of accommodating any further adjustments to DNO losses reporting for 2009-10 would be to include them as part of the DPCR4 LRRM close out calculations. Our decision on the amount of the revenue adjustment term (PPL) associated with the DPCR4 LRRM incentive will be set out in a direction no later than 30 November, 2012, and will be reflected in the UoS charges effective from 1 April, 2013. However we stated that we would consider any applications made before 15 April, 2011¹⁹ in advance of the LRRM calculation. Ofgem received two applications to restate 2009-10 losses before this date, from SP (SP Manweb and SP Distribution)²⁰ and ENWL.

2.22. All of the other DNOs indicated that they believe they are affected by the data adjustment issue to a greater or lesser degree, and will be applying to restate 2009-10 losses as part of the DPCR4 LRRM process.

ENWL application

2.23. The approach used by ENWL to rectify the reported 2009-10 losses position is the same as the methodology used by CE, and they provided an equivalent level of evidence of the effect of supplier billing adjustments. The Authority therefore agreed to restate ENWL's losses incentive information for 2009-10, in line with their application.²¹

2.24. Our decision in this case highlighted that Ofgem would consult on the most appropriate methodological approach to use, and that the decision on this methodology will allow us to reach decisions on any remaining restatement applications by DNOs. We stated that the outcome of this consultation could lead to a review of the interim decisions already taken on CE and ENWL.

SP application

2.25. The approach proposed by SP in their application is broadly similar to that of CE and ENWL in that it is a top down estimation of the level of losses that would have been experienced if supplier data corrections hadn't taken place. However their methodology is different in several respects (SP's methodology is explained in more detail in the next chapter). We therefore decided to consult further on the preferred methodology to use before deciding on the SP application.

¹⁹<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=519&refer=Networks/ElecDist/PriceCtrls/DPCR5>

²⁰[http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/SP%20Losses%20Submission%20\(redacted\).pdf](http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/SP%20Losses%20Submission%20(redacted).pdf)

²¹<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=601&refer=Networks/ElecDist/PriceCtrls/DPCR5>

2.26. SP enlisted the services of Engage Consulting Limited ('Engage') in developing their methodology. Using this methodology, Engage have also set out how it could be applied to DNOs who had different losses reporting methodologies for DPCR4.²²

Other initiatives

2.27. Several DNOs attempted to obtain further supporting data from suppliers in order to analyse the corrections and develop a suitable methodology. Some DNOs attempted formal supplier surveys, while others requested further information on a more informal basis. These initiatives were of limited benefit, reflecting the fact that DNOs have no formal means to obtain data from suppliers and the limited information which suppliers in fact hold on data adjustment history. However, in general it has become clear that much of the data which would be required to undertake a comprehensive bottom-up exercise is simply not captured or stored by most suppliers.

2.28. The industry set up a Distribution Charging Methodologies Forum (DCMF) Working Group (comprising representatives from DNOs, suppliers, Elexon and Ofgem) in response to concerns regarding the adjustments to data and the resulting impact on charges. The group has considered the settlement data issues which have given rise to the problem, and has discussed the different methodologies put forward. Following group discussions, several modifications to the BSC are being proposed, in order to improve settlements data accuracy going forwards.

²²<http://www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR5/Documents1/SP%20Methodology%20Paper%20by%20Engage%20Consulting%20App%201.pdf>

3. Normalisation of 2009-10 settlements data

Chapter Summary

This chapter sets out the methodology used for the two interim decisions made to date; and provides information on the alternate methodology proposed.

Question box

Question 1: Do you agree with the general principles and constraints we have identified with respect to the correction of data used for the losses incentive scheme?

Question 2: Do you think we have identified the only two practical methodologies for normalising losses incentive data for 2009-10? If not, what other approaches do you think we should consider?

Question 3: Do you agree that Options 1 and 2 are distinct approaches such that a hybrid incorporating the best points of each is unachievable?

General principles and constraints

3.1. In response to our consultations to date, and in industry discussions, the broad consensus appears to be that there are insufficient records of settlement adjustments made in 2009-10 to be able to accurately unpick them. A top-down approach that aims to calculate, to a reasonable degree of accuracy, what the DNOs' losses performance should have been appears to be the only viable option.

3.2. The DCMF Working Group has debated various ways of dealing with the existing settlements data concerns associated with the losses incentive calculation. Despite a considerable amount of attention to this issue, the only two approaches to allow restatement of the 2009-10 losses information to have emerged are the CE methodology (also used by ENWL) and the methodology proposed by SP (Engage generic methodology). Dealing with the effect of negative EACs is an integral part of both methodologies.

3.3. Investigation has shown that the data adjustments have been caused by a variety of actions, not limited to GVC, but with broadly similar effects. Both methodologies aim to remove abnormal corrections.

Option 1: Methodology normalising reconciliation of R1 to R3 settlement runs ('CE methodology')

3.4. The full details on the CE methodology are set out in the CE and ENWL applications.²³ In summary, the methodology has the following steps:

- the settlements reconciliation runs R1, R2 and R3 received during 2009-10 are normalised using average reconciliation data from between 2005-06 to 2008-09 (when CE and ENWL state that settlement adjustments did not materially distort their percentage losses)
- settlement runs RF and DF (when CE and ENWL believe the majority of abnormal adjustments were made for 2009-10) are disregarded and set to zero
- the identified negative EAC values in 2009-10 are replaced with positive profile average values associated with the meter points (MPANs²⁴) concerned (it should be noted that this is how negative EACs are treated in the Elexon system since a rule change in 2010)
- the DNO must continue to monitor the MPANs which were adjusted and note any which achieve positive EACs after a valid meter read is recorded. Any units reported against this group of meters must be deducted from reported units distributed until the total units allowed under the decision have been 'used up'.

3.5. CE state that their methodology assumes that data at the time of the first (SF) settlement run is valid, but normalises later reconciliation levels which are assumed to have been affected by the supplier data cleansing. The approach is intended to neutralise the abnormal GVC effect in 2009-10 while 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.

3.6. CE believe that the bulk of the corrections that have impacted their losses reporting can probably be attributed to GVC activity. They based their analysis on data obtained from Elexon, who confirmed that they had noted abnormal trends in data during 2009-10. We understand that while the corrections would have been reflected in the 2009-10 period, the 'missing' units could pertain to an extended period of time that may even have extended before the start of DPCR4.

²³ CE Electric UK losses restatement application and ENW losses restatement application <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=555&refer=Networks/ElecDist/PriceCtrls/DPCR5>

²⁴ Further detail on MPANs can be found at www.elexon.co.uk.

3.7. CE base their approach on the view that routine changes to settlement data by suppliers are a legitimate part of the settlement process and of the behavioural norm of suppliers which prevailed when the DPCR4 targets were set. If the intensity of those programmes had remained unchanged, there would be no material inconsistency. It is the significant step change in the volume of activity and, in particular, the adjustment to long-standing data problems that creates the distortion. The underlying assumption that the effect of supplier changes would be a constant within a price control period is therefore invalidated, meaning that the comparison of actual losses against targets would not be on a like-for-like basis.

3.8. The negative EACs which are adjusted for by replacing them with profile average values will be updated once a valid meter reading is recorded. To ensure that these units are not counted twice (once in the adjustment to 2009-10 data and once in the units distributed in the period in which the valid meter reading is recorded) it will be necessary to continue to monitor each of the adjusted MPANs until all units adjusted for are fully set off. DNOs have only recently been given access to this data on a quarterly basis (P222 report). CE recognise that the approach to negative EACs does not take into account the value of any negative EACs which may have existed within the data set used to set the DPCR4 targets. However they have no reason to suppose that negative EACs were common at that date and do not think it inappropriate to make the working assumption that all negative EACs emerged during the DPCR4 period.

3.9. CE believe that they erred on the side of caution in making no adjustment for the adverse effect on reported losses of negative EACs in the years from 2005/06 to 2008/09. They also make no adjustment for EACs that may have been understated without being negative. CE believe that if the creation of negative EACs has been a consistent consequence of suppliers' behaviour over the DPCR4 period they could have suffered significant adverse impacts during the earlier years of the DPCR4 period. However there is no feasible way of identifying or correcting for this situation. If it has not been a consistent behaviour on the part of suppliers, CE could be affected by both the immediate effect under the DPCR4 losses incentive and by the effect of the DPCR4 Losses Rolling Retention Mechanism (LRRM) if these abnormal data entries are treated as a component of deteriorating losses performance.

3.10. The CE methodology leaves the SF data unadjusted. CE state that their data indicates that the recession could have been affecting the number of units entering its networks from around July 2008, approximately nine months prior to the commencement of the 2009-10 year to which CE has applied their methodology. They believe that a large number of actual meter readings taken during the recessionary period would thus have informed the SF data from April 2009. In addition, CE have highlighted that their data indicates that the winter of 2009/10 was particularly cold and resulted in a significant increase in numbers of units distributed at that time. CE therefore believe that any impact of the recession would have been at least partially offset by the effect of the colder than normal winter.

Option 2: Methodology normalising reconciliations for all settlement runs ('SP methodology')

3.11. The full details of the SP/Engage methodology are set out in the SP and Engage submissions.²⁵ In summary, the methodology as applied to SP has the following steps:


- quantification of abnormal reconciliations volumes for all settlement runs after SF are identified by comparing reconciliation levels to the average for a stable period between mid-2005 and August 2008, and then these abnormal levels are netted off against reconciliations applied for 2009-10 reporting
- normalisation of the initial settlement (SF) position against which these variations are measured

3.12. The SP/Engage methodology is premised on the fact that performance measurement should be consistent with the target setting. It also recognises that a 'normal' level of settlements data volatility exists. Accordingly it establishes a 'normal' level of reconciliation volumes for each month from a period they consider 'stable' and reflective of the situation in place when DPCR4 targets were set. It then nets these 'normal' monthly reconciliation volumes off the observed reconciliation volumes in the period when the abnormal variations have been observed. They consider that the stable period used to model variations should be at least two years (subject to data availability) but could be longer.

3.13. The methodology recognises that the initial settlement (SF) position against which these variations are measured is likely to have been impacted by the recession and by any abnormal adjustments to prior years. As mentioned in the section on the CE methodology, EACs are derived from AAs and previous EACs. As a consequence, EACs lag changes in consumer behaviour (such as in a recession) and are impacted by AAs that are not reflective of consumption (such as when compensating for an error in an earlier period). SP/Engage state that analysis of P222 data from the early part of 2010 confirms that a very significant volume of negative EACs were in place which they believe supports their approach.

3.14. The SP/Engage methodology addresses the impact of the recession and prior year adjustments by normalising the SF position. They have noted that some abnormal data adjustments began to reflect in the 2008-09 period and consider that normalisation of the SF position in 2009-10 is necessary to address this. They consider that this normalisation can be done by reasonably assuming that hypothetical losses based on SF non half hourly data across prior regulatory years

²⁵ Scottish Power losses restatement submission and Scottish Power Methodology paper by Engage Consulting
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=555&refer=Networks/ElecDist/PriceCtrls/DPCR5>



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(2006-07 and 2007-08) should approximate to the same values for 2008-09 and 2009-10.

3.15. SP/Engage consider that the methodology proposed quantifies 'abnormal adjustments' in a simple and reasonable way that could equally be applied to other DNOs, using aggregated data which is readily available.

3.16. Engage has expanded on the methodology to map the adjustments to regulatory years in a manner that can be used with other DNO regulatory losses incentive reporting practices. The methodology used by SP is based on the use of Settlement Day reporting, but Engage set out how the methodology is also applicable to other DNOs whose data systems are based on Settlement Run Date or Accounting Date reporting. This is done by allocating the abnormal variations and SF normalisation volumes determined to the appropriate regulatory year in a manner consistent with each DNO's reporting method.

4. Comparison of Options 1 and 2 and our preferred way forward

Chapter Summary

This chapter sets out our assessment of the key strengths and weaknesses of the two different methodologies together with the associated risks and impacts. It also includes a request for each DNO to provide an estimate of the comparative effect of the two methodologies to assist our decision. We outline our preferred way forward, and set out some concerns regarding ongoing data cleansing activities.

Question box

Question 1: Have we identified the important strengths and weaknesses of each option? If not, what additional points should be considered?

Question 2: Do you think that the impact of particular factors on SF data can be clearly identified? Can a recessionary impact be separated from other factors such as extreme weather? How important is it for the purposes of the adjustments methodology to also take account of other variables affecting SF data such as extreme weather conditions?

Question 3: Do you consider that both methodologies can deal equally well with all types of settlements data correction?

Question 4: Should Option 2 allow DNOs to select different 'normal' periods or is there a case for setting a standard period? What would the benefits or drawbacks be of selecting a standard 'normal' period across all DNOs? Would the selection of different 'normal' periods substantially affect the outcome?

Question 5: Do you support our preferred approach to have a single methodology that would be used across all DNOs that have adequate evidence of abnormally high settlement data corrections?

Question 6: Do you consider that Option 1 should be that single methodology? If not please give reasons for your response.

Question 7: Are suppliers still undertaking significant levels of settlement data adjustments? What has been the impact of the changes to the BSC to limit the use of GVC, and what will be the impact of P274? Are ongoing settlement data adjustments likely to be on the same scale as those observed for 2009-10?

Overview

4.1. Both methodologies use a top down approach to the restatement of 2009-10 losses data, and rely on identifying stable periods when atypically high levels of settlement adjustments did not occur. Both utilise settlement reporting methods and make use of readily available data. We therefore consider that both methodologies could be easily replicated by other DNOs if required.

4.2. Both methodologies should be able to deal with all settlement data adjustments including GVC, DMX and other techniques used to adjust settlements data.

4.3. We have highlighted some of the key strengths and weaknesses we see in each of the methodologies. The criteria we applied in considering these strengths and weaknesses included degree of transparency, fairness to customers, assumptions made, ease of audit and potential for replication by other DNOs. This assessment is not intended to be exhaustive and we invite respondents to send us their views.

Option 1 – CE methodology

Strengths


4.4. We consider that key strengths of the CE methodology are:

- it is easy to understand and can be easily replicated by other DNOs
- it makes use of observable data with limited assumptions in determining the percentage variation to be applied to each run type
- it deals with negative EACs symptomatically when they arise
- the methodological results match expected performance.

Weaknesses

4.5. Some potential weaknesses of the CE methodology are:

- it sets all RF and DF settlement data to zero which could result in valid adjustments to settlement data being discarded
- if there is an observable recessionary impact, it does not specifically address the issue



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- there is an assumption within the methodology that the data from 2005-06 to 2008-09 is “normal” and that reconciliation data for 2009-10 is corrupt
- the treatment of negative EACs could also be considered a weakness as it is based on a ‘snap-shot’ in time. Suppliers have also noted concerns about the availability of negative EAC data and the risk of negative EACs that have already turned positive being taken into account before they have in fact been included in the settlement total. In addition, while Elexon reports identify ‘high’ negative EACs there may be many others which are smaller and therefore not included
- DNOs need to monitor negative EACs which were included in the calculation of the adjustment to ensure that there is no ‘double counting’ of units.

Option 2 – SP methodology

Strengths

4.6. The key strengths of the SP methodology are:

- the methodology takes a statistically modelled approach to identify a ‘normal’ period
- it seeks to pre-empt the effect of all negative EACs before they occur
- this approach acknowledges that other factors could have altered losses performance in 2009-10 and it specifically attempts to address the effect of the recession in 2009-10 SF data
- it allows for a level of valid data adjustments to be applied to all settlements runs after SF
- it is readily applicable to all DNOs (with different reporting methodologies)
- SP used the services of an independent consultant, with extensive Elexon expertise, to develop a methodology that would address the weaknesses they considered were inherent in CE’s methodology.

Weaknesses

4.7. We consider the key weaknesses of the SP methodology are:

- The assumptions around the choice of the 'normal' settlement period based on observed patterns. While Option 1 also includes an assumption that the data for the years from 2005-06 to 2008-09 is normal, the difference is that for Option 2 the assumed normal period is a vital aspect of the methodology. The classification of a normal period is highly subjective and could differ between DNOs. The impact in the calculation resulting from selecting a different normal period has not been tested, but there are concerns as to whether DNOs using different 'normal' periods would meet the requirement of like-for-like comparison. DNOs might choose a period which gives them the most favourable result.
- Although Option 2 factors in a recessionary impact on SF, it makes an assumption that the recession is the only 'abnormal' impact and can be stripped out. It potentially leaves out of the account the impact of other valid factors (such as extreme weather conditions) which could have had a compensatory impact.

Impact of applying either methodology

4.8. The impact of the losses incentive on a DNO's rate of return can be substantial and can affect the UoS charges levied by the DNO.


4.9. In response to the CE decision²⁶, some electricity suppliers expressed concern regarding its impact on CE's indicative charges,²⁷ which were significantly higher than they would have been without the decision. They also expressed concern around the timing of the decision, which they felt did not give them adequate notice to prepare for the impact.

4.10. We have stated that in reviewing the methodologies we want to allow suppliers and their customers as much notice as possible of UoS charge impacts whilst ensuring that our treatment of DNOs is fair. We therefore set out that the impact of our ENWL decision would not apply to charges before 1 April 2012. Any

²⁶ Decision on request from CE Electric UK for consent to restate losses information for 2009-10

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/Documents1/Decision%20on%20request%20from%20CE%20Electric%20UK%20to%20restate%20losses%20for%202009-10.pdf>

²⁷ DNOs publish early forecasts of their allowed revenue positions on the DCUSA website (<http://www.dcusa.co.uk/Public/Documents.aspx?t=10>) and electricity suppliers refer to this information in their own retail tariff planning. While these forecasts do not have the same status as indicative charge publications, which are stipulated in the electricity distribution licence, they are a useful tool for suppliers and facilitate competition in the retail market



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further adjustments made as part of the LRRM close-out process will be reflected in the UoS charges effective from 1 April, 2013. These adjustments will include a time-value adjustment to recognise the delay to the DNO receiving its corrected revenues.

4.11. As stated earlier, the decision on the methodology could result in a further adjustment to the CE and ENWL losses which would have an impact on their revenue and UoS charges. However, this would not be reflected in their UoS charges until 1 April 2013.

Comparison of effect of both methodologies on DNO calculations

4.12. We have set out at the start of this chapter our high level views on the strengths and weaknesses of the two methodologies. In order to further inform our decision, we would like to compare the relative effect on each DNO of applying each of the methodologies to their reported positions and possible proposed adjustments. We have therefore included a brief questionnaire (Appendix 2) for each DNO to complete. The results will give a high level picture of the different effects of the two methodologies, and will indicate the relative impact on revenue from either methodology.

4.13. We request that each DNO (at licensee not group level) completes and returns the questionnaire to Ofgem within six weeks of the publication of this consultation paper. The figures provided will not be considered definitive and will be treated without prejudice to any restatement application received as part of the LRRM close-out process. We note that the CE and ENWL licensees will only need to complete the section for Option 2; and the SP licensees will only need to complete the section for Option 1.

4.14. We recognise that this questionnaire is limited and that some of the assumptions could affect the results obtained. In particular, we refer to the assumption of a standard 'normal' period as part of SP's methodology, and whether the same period applies to all DNOs. We would expect a DNO to comment on this period, particularly if they consider that there is justification for a different normal period to be selected in their case. For the purposes of this exercise we would expect all DNOs to respond based on the same 'normal' period as used by SP, even though one of the key points of the SP/Engage methodology is the ability to choose a 'normal' period based on observations of when adjustments started to impact on a DNO's data.

Preferred way forward

4.15. Having considered the relative strengths and weaknesses of both methodologies, our present preferred way forward is that any further applications for adjustment which are supported by adequate evidence will be considered using Option 1 (the CE methodology). This preference is particularly due to some

discomfort around the assumptions affecting adjustments to SF in the SP methodology.

4.16. We favour a single methodology that would be used across all the DNOs that have evidence of abnormally high settlement data corrections. However, we recognise that the different types of data correction, and different levels of volatility occurring in each of the DNO areas, will have an impact on the need for restating losses for 2009-10 and the relative impact of each of the methodologies. We therefore acknowledge that there is not necessarily a 'one size fits all' response to the issues, and that there may be a case for applying a different methodology depending on the particular cause of the data volatility.

4.17. We will wait to see the results of the questionnaire mentioned above before forming an opinion on the effect of each methodology on the losses incentive position and therefore allowed revenue of each DNO. We will also carefully consider the responses to this consultation in formulating our final position.

Ongoing settlements data cleansing by suppliers

4.18. The decision on the methodology is intended to be applied to the 2009-10 losses data only. While suppliers have highlighted that they are continuing with data cleansing exercises we do not consider that any ongoing volatility in settlements data will be on the same level as that noted in 2009-10. However, we will keep this situation under review.

5. Interaction with the losses rolling retention mechanism and targets for DPCR5

Chapter Summary

Restating losses for 2009-10 will impact on the LRRM and DPCR5 target calculations as set out in the DPCR5 Final Proposals. This chapter sets out our consultation on how the LRRM and DPCR5 target setting processes may need to be amended.

Question box

Question 1: Do you agree that in calculating the LRRM, the selected adjustment methodology should be applied to the 2009-10 losses reported under both the DPCR4 and DPCR5 methodologies?

Question 2: Do you believe that either Option 1 or Option 2 could be applied to the 2009-10 losses re-reported under the DPCR5 common reporting methodology?

Question 3: Do you agree that in setting the DPCR5 ALP we should not include any settlements data adjustment?

Question 4: Do you believe that the type of adjustment (GVC, DMX or other) impacts how the targets should be calculated? If so, how should this be done?

DPCR4 LRRM close out and DPCR5 target setting

5.1. The 2009-10 losses not only drive the losses incentive received by a DNO in that year, but also feed in to the LRRM calculation and the calculation of the targets for DPCR5.

5.2. In the previous chapters we have set out the proposed methodologies for normalising settlement data and hence recalculating the reported losses for 2009-10. These proposals have been made under the licence in place during DPCR4 which allowed the DNOs, where permitted by Ofgem, to use a different losses reporting methodology to that historically applied.

5.3. In DPCR5 we moved to a common reporting methodology. We also set out in the DPCR5 Final Proposals how the LRRM and the DPCR5 targets would be calculated based on this common reporting methodology. Unlike DPCR4, there is no facility for DNOs to diverge from the DPCR5 methodology.

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5.4. We set out below how we propose to amend the DPCR5 methodology when applied to the LRRM in order to include the settlements data normalisation. We also consult on whether it is appropriate to make any amendment to the calculation of the DPCR5 targets.

LRRM

5.5. In Final Proposals we set out how we would close out payments under the DPCR4 losses incentive mechanism and how we would implement the LRRM.

5.6. The close out and LRRM calculation includes adjustments to ensure that there are no windfall gains or losses to the DNO arising from

- settlement data corrections and provision accounting
- changes in reporting methodology
- adjustments to the DPCR5 targets.

5.7. We set out in Final Proposals that the LRRM would be calculated according to the following formula:²⁸

Corrected Net LRRM incentive = $5 \times IR \times (TL_{2009/10} - TL_{DPCR5} - (ACL_{2009/10} - ACL_{2009/10}^2))$
where

IR is the price indexation adjustment

$TL_{2009/10}$ is the target losses for 2009-10 and is calculated as the DPCR4 losses target multiplied by the units distributed in 2009-10 reported using the DPCR4 methodology ($LUD_{2009/10}$)

$TL_{DPCR5} = (ALP_{DPCR5} \times UD_{2009/10}) + S$

UD is the units distributed (GWh) re-calculated using the DPCR5 common losses reporting methodology

S is the forecast DPCR5 annual level of substation electricity usage previously reported as losses in DPCR4 (GWh).

$ACL_{2009/10}$ is the losses in 2009-10 reported using the DPCR4 methodology

$ACL_{2009/10}^2$ is the losses in 2009-10 re-reported using the DPCR5 methodology

²⁸ For further detail and explanation of the formula see Chapter 4 of DPCR5 Final Proposals – Financial Methodologies

5.8. In Final Proposals we state that we will require DNOs to report corrections to the DPCR4 losses that take place after the end of DPCR4, so that the final year reported losses can be revised accordingly. This is termed $LUD_{2009/10}$ in the Corrected Net LRRM incentive formula above. Where we have agreed that a DNO can normalise abnormal settlement corrections, they should use their normalised figure in $LUD_{2009/10}$ - but still include any additional adjustments required to close out the use of provision accounts where appropriate.

5.9. As stated above $ACL2_{2009/10}$ is the 2009-10 losses re-reported using the DPCR5 methodology. This means that any adjustment approved by Ofgem to normalise abnormal settlement corrections in 2009-10 will need to be included in this figure. We therefore propose that the selected correction methodology is re-run using 2009-10 data reported according to the DPCR5 common methodology in order to give a revised $ACL2_{2009/10}$ for the purposes of the LRRM calculation. This will also give a revised figure for the units distributed in 2009-10 re-reported using the DPCR5 methodology - $UD_{2009/10}$.

Targets

5.10. We set out in Final Proposals that the DPCR5 targets will be calculated using the average of DPCR4 losses re-reported using the DPCR5 reporting methodology. This means that, without explicit adjustment, the DPCR5 targets would be calculated including the abnormal settlement data in 2009-10.

5.11. Depending on the type of corrections and volume of activity going forwards, this may be appropriate.

5.12. For GVC adjustments, suppliers and DNOs have indicated that the atypically high numbers of adjustments to settlement data made in 2009-10 were corrections and that the units could be attributed to corresponding errors in previous years. Initial information received was that the corrections could reflect units relating to periods prior to the DPCR4 period. However subsequent review and information from suppliers has been that adjustments which have arisen over periods of longer than five years would be minimal, and that the high level of adjustments is largely due to the large volume of data cleansing rather than to accumulated units going back over a number of years. If the 2009-10 data contains corrections relating to previous years in DPCR4, it can be argued that it would be appropriate to calculate the average losses over the DPCR4 period as the average including the abnormal settlement data, since the corrected units arose in the previous years.

5.13. However we have also been told that many corrections did not include significant retrospective compensatory elements and only served to set consumption levels for affected meter points to appropriate ongoing levels. This premise is supported by the observation that corrections attributed to GVC are in line with those attributed to other sources such as DMX, which does not contain a compensatory element.

5.14. This means that if the supplier correction activity has reduced post 2009-10, as a result of the BSC GVC modification or other actions, then the 2009-10 losses can be considered an anomaly with respect to setting the DPCR5 targets. In this case the selected correction methodology should be applied to the 2009-10 data before calculating the DPCR4 average.

5.15. We welcome views on whether the selected correction methodology should be applied to the DPCR4 losses data before calculating the DPCR5 losses targets, and whether this varies depending on the type of settlement adjustments used by suppliers (GVC, DMX or other).

Calculator tool

5.16. We have published alongside this consultation a draft calculation tool in Excel® setting out an approach to the DPCR4 LRRM/DPCR5 ALP calculation to aid the DNOs in calculating the impact of the different methodologies. We intend that the calculations are based on the LRRM as outlined in Final Proposals, however if there are any inconsistencies between this workbook and Final Proposals then the latter prevails.

5.17. We encourage DNOs to use the workbook to assist in analysing the impact of both the CE and SP methodologies on their allowed revenue and UoS charges. The tool should clarify the interaction between the restatement of the 2009-10 losses information and the DPCR4 LRRM/DPCR5 ALP calculation.

Other issues

5.18. In the process of addressing the settlements data issues to-date, some companies have also raised additional questions and concerns affecting the broader LRRM and target setting process. These include the interaction of the LRRM and the DPCR5 losses cap and collar and the impact of adjustments made to some companies' DPCR4 targets. We are reviewing these issues and will address them through a separate work stream.

6. Next Steps

Chapter Summary

This chapter sets out the processes prior to making a final decision on the methodology to be used for any adjustments to 2009-10 reported losses. It also sets out the associated timelines and the expected timescales for any resultant effect on charges.

Consultation process

6.1. We welcome the views of interested parties in relation to any of the issues set out in this document. Responses should be provided no later than 20 December 2011.

Stakeholder event

6.2. We will host a stakeholder workshop towards the end of November 2011 to discuss any issues of clarity or matters arising from the consultation. The workshop is also intended to provide a forum for DNOs to raise issues regarding the return of the questionnaire, and to further discuss the calculator tool provided.

6.3. All interested parties should contact Stephen Perry (Stephen.Perry@ofgem.gov.uk) before 15 November 2011 to register their interest in attending the workshop.


Submission of estimated outcomes questionnaire

6.4. All DNOs will be expected to submit the estimated outcomes questionnaire to Lesley Ferrando (Lesley.Ferrando@ofgem.gov.uk) by Tuesday 6 December 2011.

6.5. While the information contained in these questionnaires will be treated as confidential, a summary of the key outcomes of the questionnaire will be placed on the Ofgem website by 12 December 2011 to inform final submissions to the consultation.

Final decision on consultation

6.6. We intend to publish our final decision on this consultation no later than 30 January 2012. This decision will reflect the responses to this consultation and views provided through the stakeholder event.



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6.7. We will include in our decision the further process to be followed by any DNOs seeking to adjust the methodology by which their 2009-10 losses have been calculated.

Next steps

6.8. Following the final decision on the methodology, we will make a decision on the request by SP (SP Manweb and SP Distribution) for consent to calculate distribution losses for 2009-10 on a basis that differs from that specified to under special licence condition C1. Any revenue impact will be factored into their April 2013 charges.

6.9. We will also commence the process of calculating the DPCR4 LRRM and the DPCR5 targets, both of which are required to be finalised before 30 November 2012. As part of this process we will consider whether we need to review our interim decisions taken on the CE and ENWL applications, and take into account any further or better information available at the time.

6.10. As part of the LRRM process we will also process any further applications received from DNOs to recalculate 2009-10 losses for the purposes of calculating the LRRM and DPCR5 ALP targets which are supported by the necessary data.

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Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document. In particular, we would like to hear from Distribution Network Operators and Suppliers.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 20 December 2011 and should be sent to:

- Lesley Ferrando
- Local Grids and Governance: Distribution
- 9 Millbank, London, SW1P 3GE
- 0207 901 1808
- Lesley.Ferrando@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to issue a decision on the settlements data adjustment methodology and the impact on the LRRM and DPCR5 ALP processes. Any questions on this document should, in the first instance, be directed to:

- Lesley Ferrando
- Local Grids and Governance: Distribution
- 9 Millbank, London, SW1P 3GE
- 0207 901 1808
- Lesley.Ferrando@ofgem.gov.uk

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CHAPTER: Two

Question 1: Do you think we have identified the main data/billing adjustment techniques used by electricity suppliers and their impacts?

Question 2: Are there any other factors you think we should take into consideration in assessing the impact of settlement data volatility?

CHAPTER: Three

Question 1: Do you agree with the general principles and constraints we have identified with respect to the correction of data used for the losses incentive scheme?

Question 2: Do you think we have identified the only two practical methodologies for normalising losses incentive data for 2009-10? If not, what other approaches do you think we should consider?

Question 3: Do you agree that Options 1 and 2 are distinct approaches such that a hybrid incorporating the best points of each is unachievable?

CHAPTER: Four

Question 1: Have we identified the important strengths and weaknesses of each option? If not, what additional points should be considered?

Question 2: Do you think that the impact of particular factors on SF data can be clearly identified? Can a recessionary impact be separated from other factors such as extreme weather? How important is it for the purposes of the adjustments methodology to also take account of other variables affecting SF data such as extreme weather conditions?


Question 3: Do you consider that both methodologies can deal equally well with all types of settlements data correction?

Question 4: Should Option 2 allow DNOs to select different 'normal' periods or is there a case for setting a standard period? What would the benefits or drawbacks be of selecting a standard 'normal period' across all DNOs? Would the selection of different 'normal' periods substantially affect the outcome?

Question 5: Do you support our preferred approach to have a single methodology that would be used across all DNOs that have adequate evidence of abnormally high settlement data corrections?

Question 6: Do you consider that Option 1 should be that single methodology? If not please give reasons for your response.

Question 7: Are suppliers still undertaking significant levels of settlement data adjustments? What has been the impact of the changes to the BSC to limit the use of



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GVC, and what will be the impact of P274? Are ongoing settlement data adjustments likely to be on the same scale as those observed for 2009-10?

CHAPTER: Five

Question 1: Do you agree that in calculating the LRRM, the selected adjustment methodology should be applied to the 2009-10 losses reported under both the DPCR4 and DPCR5 methodologies?

Question 2: Do you believe that either Option 1 or Option 2 could be applied to the 2009-10 losses re-reported under the DPCR5 common reporting methodology?

Question 3: Do you agree that in setting the DPCR5 ALP we should not include any settlements data adjustment?

Question 4: Do you believe that the type of adjustment (GVC, DMX or other) impacts how the targets should be calculated? If so, how should this be done?

Appendix 2 – Estimated outcome questionnaire for DNOs

1.1. All DNOs (each licensee not each group) are requested to complete and return this questionnaire by 6 December 2011. The figures provided will be for comparative purposes and will not prejudice any further restatement application. (Note: CE and ENWL licensees only need to estimate the Option 2 outcome, while SP licensees only need to estimate the Option 1 outcome).

DNO name: _____

Original number of units reported as distributed in 2009-10:	
EHV	
HV	
LV1	
LV2	
LV3	

Option 1

1) Number of units added to 2009-10 by changing R1 to R3 reconciliation adjustments applied to the average level for 2005-06 to 2008-09	
2) Number of units added to 2009-10 by changing RF and DF reconciliation adjustments applied to zero	
3) Number of units added to 2009-10 by changing negative EAC values to the profile average value	

Estimated revised number of units to be reported as distributed in 2009-10:	
EHV	[same as original reporting]
HV	[same as original reporting]
LV1	

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LV2	
LV3	

Option 2

1) Number of units added to 2009-10 by changing R1 to DF reconciliation adjustments applied to the average for a stable period between mid-2005 and August 2008	
2) Uplift to SF distribution levels for 2008-09 as a result of assuming that loss percentages should be the same as the average for the preceding three regulatory years	
3) Uplift to SF distribution levels for 2009-10 as a result of assuming that loss percentages should be the same as the average for the preceding three regulatory years	
4) Number of units added to 2009-10 by allocating the additional units identified in steps 2 and 3 to reconciliation run adjustments in 2009-10	

Estimated revised number of units to be reported as distributed in 2009-10:	
EHV	[same as original reporting]
HV	[same as original reporting]
LV1	
LV2	
LV3	

Comments:

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Appendix 3 - Glossary

A

Annualised Advance (AA)

The rate of consumption over the period between two meter readings, nominally expressed as kWh/year.

Allowed Loss Percentage (ALP)

The target losses percentage determined for each DNO.

B

Balancing and Settlement Code (BSC)

The legal document setting out the rules for the operation and governance of the Balancing Mechanism and Imbalance Settlement. All licensed electricity generators and suppliers must sign up to the BSC and other interested parties may also choose to do so.

D

Dummy Meter Exchange (DMX)

Use of the meter change event process to update data in the balancing and settlement system when no physical meter change has taken place.

Distribution Network Operator (DNO)

One of the licensed operators of the fourteen regional electricity distribution networks in Great Britain.

Distribution Price Control Review 5 (DPCR5)

DNOs operate under a price control regime, which is intended to ensure DNOs can, through efficient operation, earn a fair return after capital and operating costs while limiting costs passed onto customers. Each price control has typically lasted five years. DPCR5 is the existing price control that commenced on 1 April 2010 and will end on 31 March 2015.

Distribution Use of System (UoS) Charges

Charges paid for the use of the distribution network.

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E

Elexon

The Balancing and Settlement Code Company – see www.elexon.co.uk.

G

Gross Volume Correction (GVC)

A facility within the balancing and settlements system to correct errors relating to meter advance periods in respect of which some settlement dates have already been subject to the final (RF) reconciliation run.

L

Losses Incentive Mechanism (LIM)

Introduced as an incentive mechanism within the price control to encourage DNOs to reduce losses incurred on their networks.

M

Meter Point Administration Number (MPAN)

Unique identification number within settlements for each meter point.

S

Settlement Day (SD)

Term used in the BSC settlements process and is the period from 00:00 hours to 24:00 hours on each day.

Settlement Runs

The BSC settlements process consists of a number of data runs to update settlements data before data is considered final.

Settlement Run Types	Approximate Period after Settlement Day
Initial Settlement – SF	17 Working Days
First Reconciliation – R1	2 Months
Second Reconciliation – R2	4 Months
Third Reconciliation – R3	7 Months
Final Reconciliation – RF	14 Months
Dispute Final - DF	Up to 28 months

Appendix 4 - Feedback Questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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