Ofgem losses workshop

CE adjustment methodology

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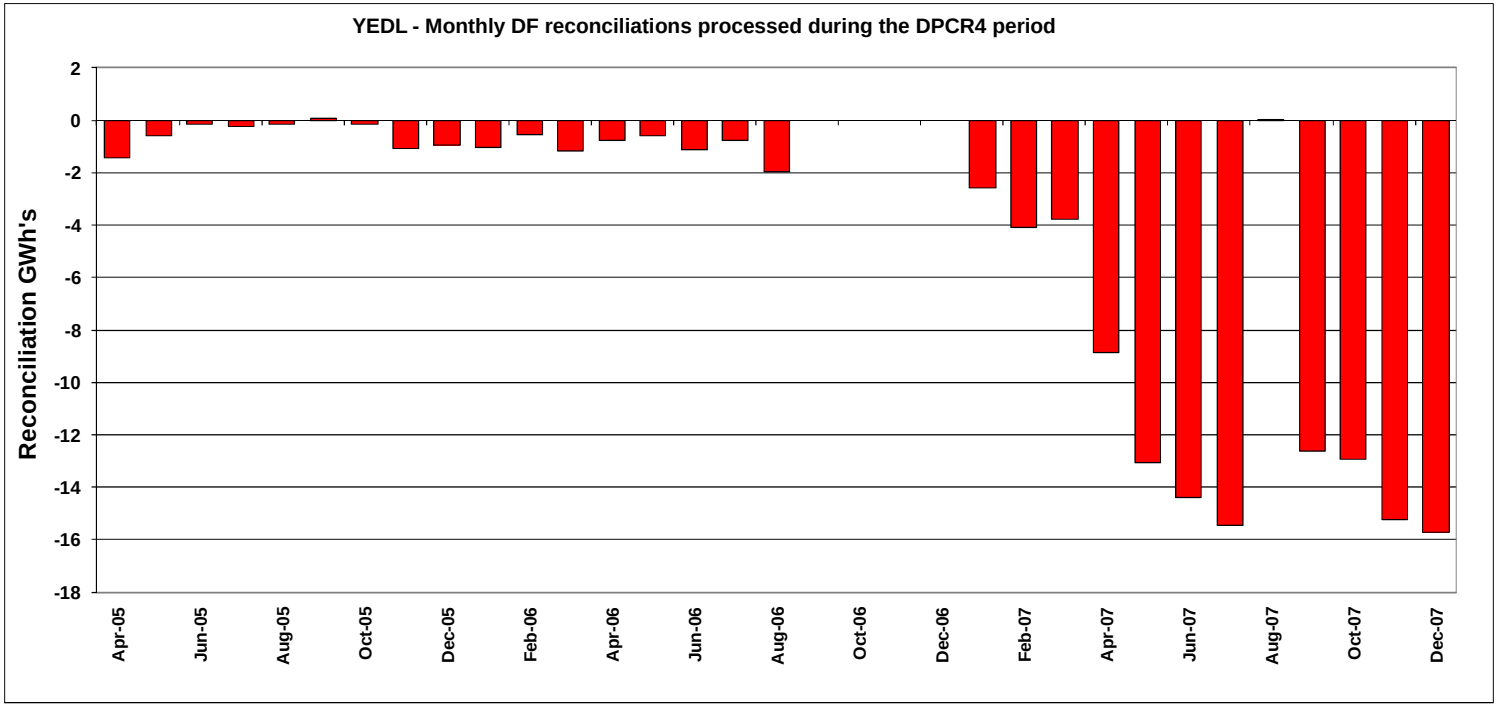
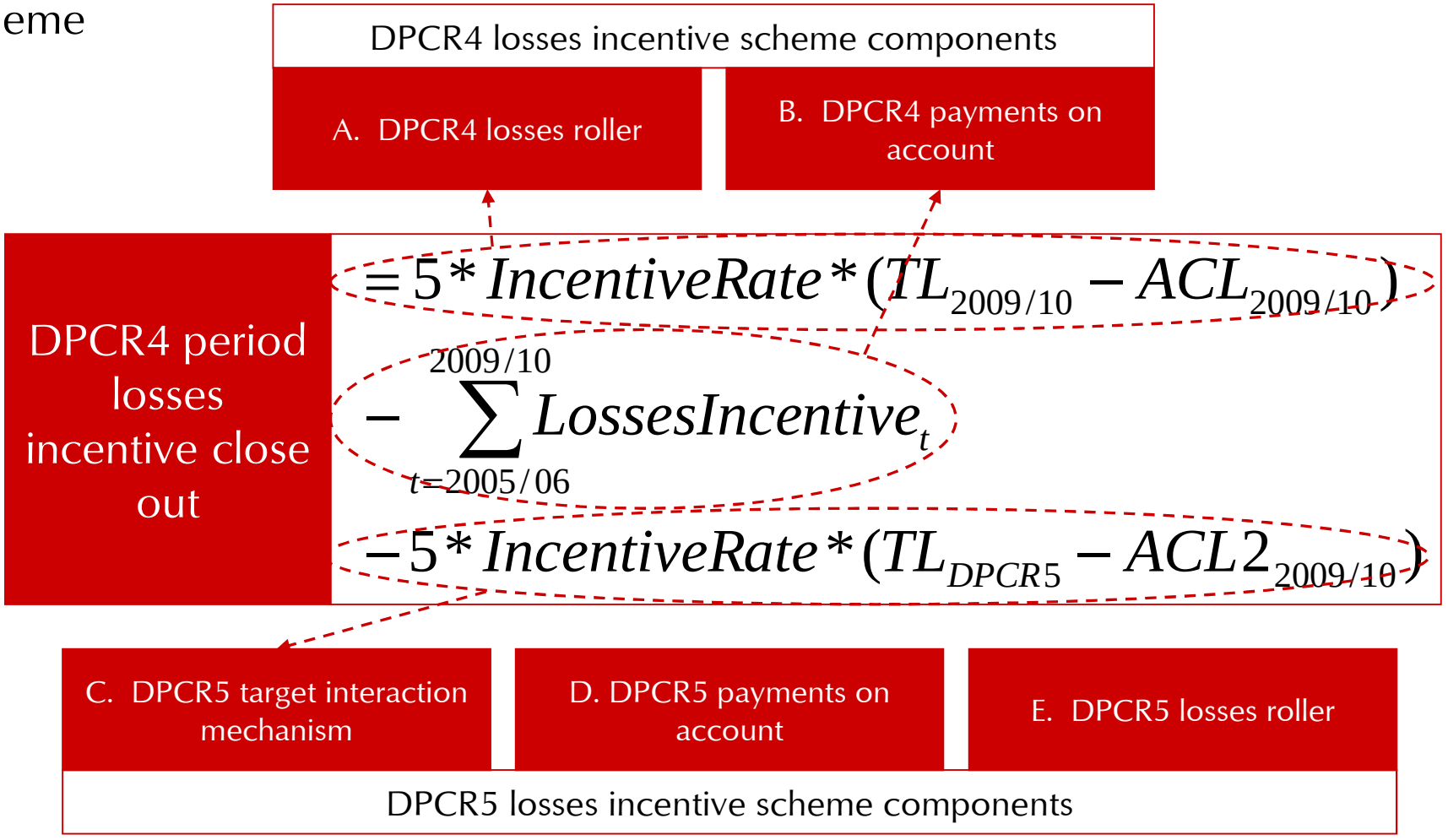
Supplier data corrections in the last year of DPCR4, continuing into DPCR5, are having an exceptional impact on Northern Powergrid losses performance



- We have investigated this thoroughly since January 2010 and appreciate the open dialogue we have had with suppliers and other industry experts
- We are not saying anyone has broken any rules, indeed overall data quality ought to improve
- However, increased supplier activity has radically distorted the losses data, leading to unintended consequences for the relationship between targets and performance under the losses incentives

The DPCR4 close out *(A-B-C)* is complicated:

It comprises 5 x 2009-10 incentive value, less the money already earned/lost, and, adjusts for perceived unearned gains/losses from transition to the DPCR5 scheme



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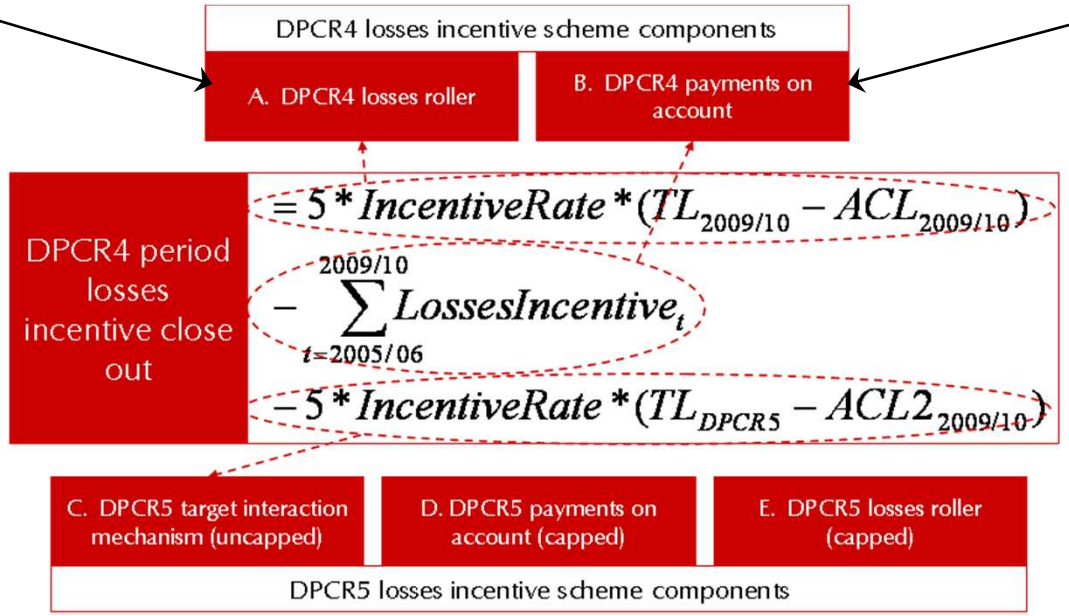
The CE method is applied to ensure consistency for the DPCR4 roller closeout (A); specifically the value for $ACL_{2009/10}$

Ofgem's DPCR5 Final Proposals specify the use of *reconciled* data for the DPCR4 roller outcome –

Step 2 therefore requires the completion of adjustments to the data received in relation to 2009/10 beyond March 2010 to uphold consistency and arrive at $ACL_{2009/10}$ in component A.

Step 1 comprises the Ofgem approved *CE method*, for adjusting 2009/10 *annual* losses to take account of exceptional supplier data correction activity on the data received between April 2009 and March 2010.

This impacts the value of component B.



Consistency between the basis of target setting and measuring performance is necessary

The CE method seeks to reconstruct a dataset that would have occurred in the absence of increased supplier data correction activity

* Ofgem decision, published December 2010

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With so much resting on 2009/10, any DNO seeking an adjustment must ensure a clearly evidenced case

- Our principles seek a balanced, yet appropriate, resolution to an unintended set of consequences:
  - A bad result on losses is not, in itself, justification for an adjustment
  - Evidence always trumps speculation, we focused on the actual data and events as far as we could (such as from when it was clear that supplier activity increased)
  - We would always recognise that the theoretical best answer would be to 'unpick' each of the supplier corrections
  - In the absence of a readily available supplier audit trail, the least worst adjustment is the one that gets closest
  - The adjustment is not going to deliver the perfect result, consequently where our method leaves doubt, we err on the side of the customer
  - We used other information, such as Elexon profiles, to cross-check our answer
- The increase in supplier GVC activity on the Northern Powergrid GSP groups did not materially relate to units reported as supplied before the DPCR4 period. A change to DPCR4 targets is not required.
- We have not made any changes to our network that could cause a shift in losses performance of this size

Our detailed review led us to a method that is right for our situation, and may well be right for other DNOs

The CE Method

- Seeks to reconstruct a dataset that would have occurred in the absence of increased supplier data correction activity
- Establishes a 'normal' period by examining absolute data and time
- Then normalises the period impacted by increased supplier activity
- Adjustments are applied to
  - Settlement runs RF and DF to zero
  - Settlement runs R1, R2, R3 are normalised using the arithmetic average of the reconciliation movements from 2005/06 to 2008/09
- Deems negative EACs (a consequence of GVC) to be implausible, adopting class average EACs instead

It's Merits

- Easy to understand - can be replicated by other DNOs, if the same issue has arisen
- Uses observable data and discernable time periods
- Less reliant on subjective assumptions in assessing the variation to apply
- Reflects the practical nature of supplier activity on the reconciliation stages, avoiding SF adjustment
- The timing of the recession is largely reflected in the SF run from which the CE method proceeds
- Deals with negative EACs symptomatically, consistent with an Elexon rule change; avoids double-counting
- Allows a degree of validation by reference to independent third party data sets (e.g. Elexon data)
- Is explicitly biased in favour of the customers where judgments are in the balance

Implications for DPCR5 target setting: is this the last time we might need this method?

- DPCR5 targets need to be set using unadjusted DPCR4 reconciled performance, at least, to reduce the likelihood of future change requests
  - Supplier data correction activity continues
  - Isolating these impacts from underlying performance is currently not possible
  - The dataset inclusive of changes made by suppliers is the most reflective of what can be expected to flow in the DPCR5 period
  - DNO losses performance will also be influenced by whether supplier data correction activity increases, remains about the same, or reduces
- Despite these qualifications it is currently the case that the *best* chance of achieving any degree of consistency lies in using unadjusted DPCR4 data to set the DPCR5 targets
- Then there's the impact of the smart meter rollout to think about - we can confidently expect the smart meter installation programme to bring more data distortion

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