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Consultation on conflicts in the Distribution Losses Incentive Mechanism and data to be used in calculating its components

Consultation

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Publication date:	28 March 2012	**Team:**	Distribution Policy
Response deadline:	9 May 2012	**Tel:**	020 7901 1851
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Overview:

Under their price controls, Distribution Network Operators (DNOs) are incentivised through the Losses Incentive Mechanism to reduce electricity losses on their network. There is currently a conflict between two of a number of components of the losses Incentive Mechanism which, if not resolved, could result in a windfall revenue loss or gain for DNOs and could remove the incentive for them to reduce losses. This document consults on options to resolve this conflict.

We are also consulting on our approach to setting the Losses Rolling Retention Mechanism (LRRM) and Allowed Loss Percentage (ALP) for those DNOs that may receive restatement of their 2009-10 losses data due to abnormal levels of settlement data corrections.

This consultation continues a package of work on losses. All preceding work and associated documents can be found here: www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Pages/DPCR5.aspx.

We are seeking responses to this consultation by 9 May 2012. Responses should be sent to stephen.perry@ofgem.gov.uk. Unless clearly marked as confidential, all responses will be published on Ofgem's website.

Contents

1. Introduction

Chapter Summary

This chapter provides an overview of the consultation, sets out the policy background and describes the issues that this document seeks to address

Overview

1.1. The Distribution Losses Incentive Mechanism that applies to the fourth distribution price control (DPCR4) includes an "interaction adjustment"; intended to ensure that no DNO benefits financially from a starting position in the fifth price control (DPCR5) without taking action to reduce losses. Separately, the Distribution Losses Incentive Mechanism that applies to DPCR5 includes a "cap and collar" on the amount a DNO can receive to reduce any outstanding risk to both DNOs and consumers.

1.2. Currently the "interaction adjustment" and the "cap and collar" work in isolation but together create a conflict which, if not addressed, is likely to undermine the incentive to reduce losses and result in unmerited financial loss or gain for DNOs. Chapter 2 of this consultation seeks views on five options put forward to address this conflict.

1.3. Chapter 3 goes on to consider issues associated with the "close out" of the DPCR4 losses incentive mechanism. These issues originate from a period of abnormal data-cleansing activity that has affected some DNOs losses performance. These issues were considered in a previous consultation in October 2011. However they are considered further in this consultation because the potential solutions may be affected by the options put forward to address the conflict between the "interaction adjustment" and the "cap and collar".

1.4. The consultation seeks the views of recipients in response to specific questions raised, as well as any available evidence to support consideration and decision making. We are seeking the views by 9 May 2012. Unless clearly marked as confidential, all responses will be published on Ofgem's website. A decision document will be published by the summer.

Policy Background

1.5. Losses are calculated by deducting the number of units of electricity distributed, from the number of units entering the distribution network. We introduced a Distribution Losses Incentive Mechanism during the third electricity price control to incentivise DNOs to achieve an efficient level of losses on their networks. The incentive rewards or penalises DNOs based on their performance against a target Allowed Loss Percentage (ALP).

1.6. Changes were made to the Losses Incentive Mechanism between DPCR4 and DPCR5. The key differences are as follows:

	DPCR4 Losses Incentive Mechanism	**DPCR5 Losses Incentive Mechanism**
Method for calculating losses	Each DNO has own method for calculating losses, approved by Ofgem.	All DNOs use common reporting methodology, based on settlement data.
Date for reporting losses	Report losses annually in each regulatory year.	Report losses with two year lag, to allow for use of Run Final (RF) settlement data.
Target	Fixed five year target, based (for most DNOs) on average performance during previous 10 years.	Fixed five year target, based on average DPCR4 performance (adjusted using DPCR5 common reporting methodology).
Incentive Rate	£48/MWh pre-tax	£60/MWh pre-tax
Cap and Collar	No Cap and Collar	Cap and Collar on total DPCR5 incentive amount and annual smoothing thresholds.

DPCR4 Losses Rolling Retention Mechanism (LRRM)

1.7. As part of the DPCR4 losses incentive mechanism, we introduced a five year losses rolling retention mechanism (LRRM). The DPCR4 LRRM is designed to encourage loss reduction initiatives to be undertaken at any time in the price control period. The full detail was then spelt out in DPCR5 Final Proposals.[1]

1.8. The LRRM for DPCR4 (which has not yet been calculated) calculates the residual losses incentive for each DNO for the price control period. This value is referred to in the licence as the "PPL" term[2] and will be recovered by the DNOs during the remainder of DPCR5. The LRRM calculation can be broken down into three parts as follows:

	$5 \times \text{Incentive Rate} \times (TL_{2009\text{-}10} - ACL_{2009\text{-}10})$	Part 1: the "five times E" component
-	$\sum \text{Losses Incentive}_{2005\text{-}06 \text{ to } 2009\text{-}10}$	Part 2: the total DPCR4 incentive
-	$5 \times \text{Incentive Rate} \times (TL_{DPCR5} - ACL2_{2009\text{-}10})$	Part 3: the interaction adjustment

[1] The LRRM calculation is outlined in Chapter 4 of Electricity Distribution DPCR5 Final Proposals – Financial Methodologies (ref 189/09) http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR5/Documents1/FP_6_DPCR5%20Financial%20methodologies.pdf

[2] The "PPL" term is defined in the licence as the "the amount of the residual distribution losses incentive arising in the previous charge restriction period (1 April 2005 to 31 March 2010).

Where:
$TL_{2009\text{-}10} = (ALP_{DPCR4} \times LUD_{2009\text{-}10})$
$ACL_{2009\text{-}10}$ = 2009-10 losses (GWh)
And: ALP_{DPCR4} = DPCR4 allowed loss percentage (%)
$LUD_{2009\text{-}10}$= is the units distributed (GWh) in the final year

$TL_{DPCR5} = (ALP_{DPCR5} \times UD_{2009/10}) + S$
$ACL2_{2009\text{-}10}$ = 2009-10 losses recalculated using DPCR5 methodology (GWh)
And: ALP_{DPCR5} = DPCR5 allowed loss percentage (%)
$UD_{2009\text{-}10}$ = is the units distributed (GWh) re-calculated using the DPCR5 common methodology (GWh)
S = is the forecast DPCR5 annual level of substation electricity usage (GWh)

1.9. The first part of the LRRM seeks to ensure that sustainable improvements in losses performance are rewarded, irrespective of when they are undertaken within the period. To achieve this DNOs are rewarded five times their losses performance in 2009-10 (commonly referred to as "five times E"), minus rewards/penalties received/incurred by DNOs under the losses incentive mechanism during DPCR4.

1.10. The final part of the LRRM is an "interaction adjustment", which ensures that no DNO benefits from a starting position in DPCR5 that would allow them to earn under the DPCR5 losses incentive without making further reductions in losses. For example, if a DNO's losses position in 2009-10 were lower than the average of their performance for all years of DPCR4 (ie the DPCR5 target), they would automatically receive a reward in each year of DPCR5 without having to do anything. To avoid this situation the LRRM interaction adjustment claws back the reward or penalty that will automatically be incurred (based on the DNO maintaining their 2009-10 performance)[3]. This prevents DNOs from being rewarded or penalised twice for the same losses performance.

DPCR5 Cap and Collar

1.11. During DPCR4 there were no limitations on the amount of incentive (reward or penalty) that a DNO could earn or lose under the Losses Incentive Mechanism.

1.12. DPCR5 Final Proposals introduced an overall cap and collar on the incentive amount that the DNOs could receive during the period to reduce any outstanding risk to both DNOs and consumers. Alongside this overall cap and collar, a smoothing mechanism was introduced to protect suppliers and their customers from undue volatility of Distribution Use of System (DUoS) charges, as a result of annual rewards or penalties[4]. The smoothing mechanism carries forward to the next year any excess incentive outside of fixed upper or lower

[3] For the purposes of the LRRM interaction adjustment, performance in 2009-10 is calculated using the DPCR5 common losses reporting methodology.
[4] The annual thresholds are applied by the UT (upper threshold) and LT (lower threshold) terms in special licence condition CRC7

annual thresholds. The DPCR5 annual thresholds equate to one fifth of the overall DPCR5 cap and collar amounts.

1.13. During DPCR5 DNOs will not be able to earn or lose more than the equivalent of 97 basis points (pre-tax) return on equity through the losses incentive, including the DPCR5 LRRM[5].

Description of the issues this document seeks to address

Conflict between the interaction adjustment and cap and collar

1.14. As described above, the DPCR4 LRRM interaction adjustment and the DPCR5 cap and collar were designed to deliver separate policy objectives. In isolation, both operate as intended. However, it has become clear that the LRRM interaction adjustment calculation fails to consider the restrictions that the cap and collar places upon future DNO incentive amounts. This causes a mismatch between the uncapped DPCR4 LRRM interaction adjustment revenue amount and the capped DPCR5 losses revenue amount. There are two potential problems.

1.15. First, if the amount that the LRRM interaction adjustment recovers exceeds the amount that the DNO can earn during DPCR5 (due to the restrictions of the cap and collar), then the DNO will be unable to break even and will incur a revenue loss.

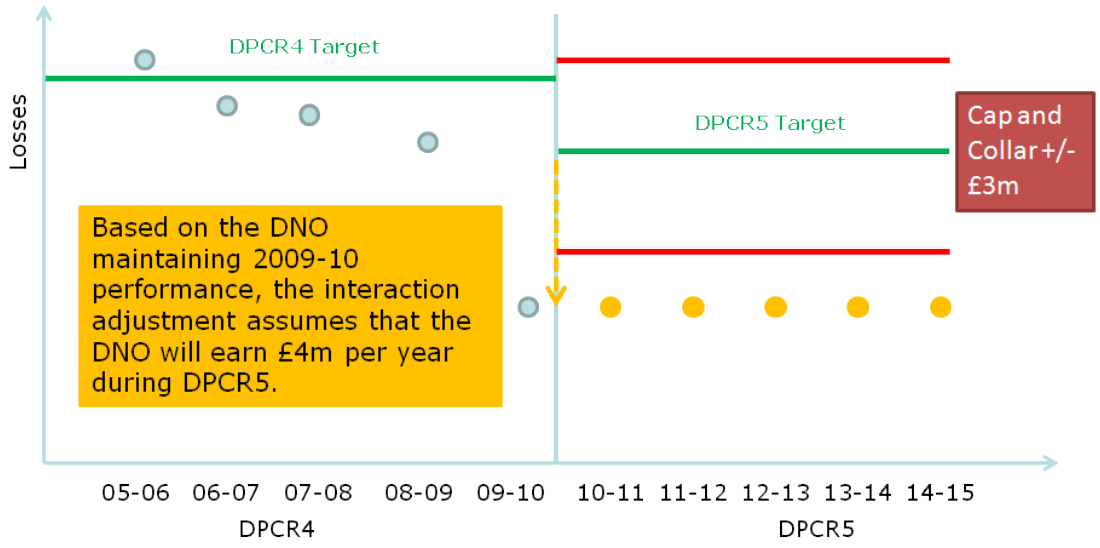

Figure 1.1: Interaction adjustment exceeds the cap

[5] The pre tax DPCR5 cap and collar amounts and annual thresholds values are stated in Appendix 1 of electricity distribution Special Licence Condition CRC7.

1.16. In this example, the LRRM interaction adjustment would claw back a total of £20m. However, compared to the cap for the period of £15m (or £3m per year) the DNO would be unable to realise £5m; a loss of £1m per year. The opposite is also possible, where the interaction adjustment pays back £20m, but the collar only allows penalties of £15m over the period. The would result in a revenue gain of £5m.

1.17. The second problem is that even if the amount that the LRRM interaction adjustment recovers does not exceed the cap and collar amount, the restrictions of the DPCR5 cap and collar create an asymmetrical revenue exposure. This means a DNO might be disproportionately exposed to either the upside or the downside of the incentive. The result is that some DNOs might have little or no incentive to improve losses performance during DPCR5.

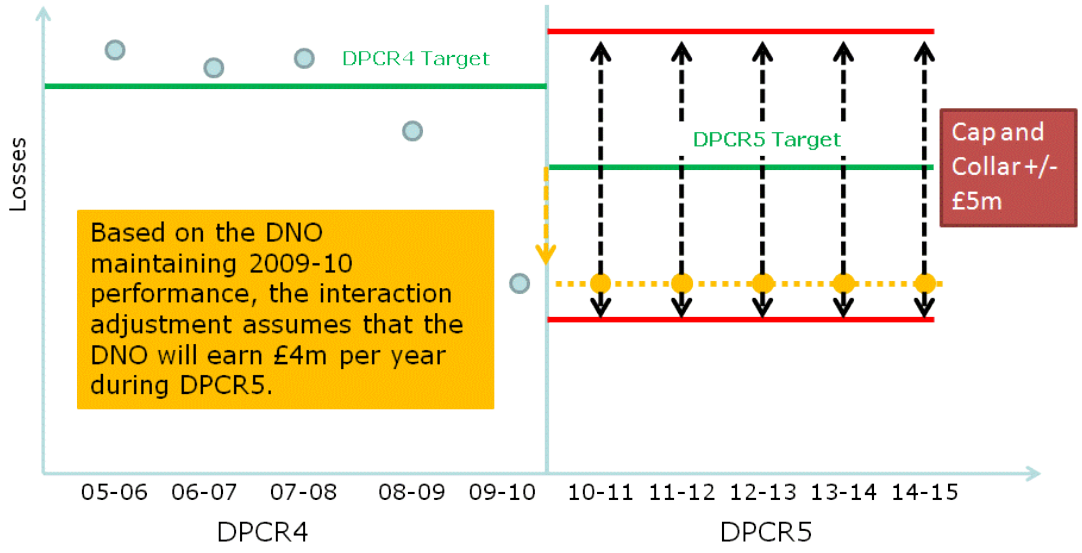

Figure 1.2: Interaction adjustment results in asymmetrical revenue exposure

1.18. In this example, the LRRM interaction adjustment would again claw back a total of £20m. However, compared to the cap and collar for the period of £25m (or £5m per year) the DNO would be eligible for a maximum reward of only £1m per year. This is regardless of whether its losses position was better, and compares with exposure to a potential annual penalty of £9m. Again, the opposite is possible.

1.19. The DPCR5 Final Proposals are silent on the need to prevent asymmetrical revenue exposure; equivalently, this document takes no position either way. However, we are concerned with an outcome that limits the overarching policy intent of the mechanism – that being to incentivise DNOs to reduce losses on their networks. For that reason, the issue of asymmetrical revenue exposure is considered in our assessment of the options put forward.

1.20. The conflict and problems explained above have been brought to our attention by DNOs who expressed concern over the impact that such a conflict might have on the policy intent of the losses incentive, as set out in DPCR5 *Final Proposals*. Chapter 2 of this document sets out options on which we are consulting, that seek to resolve this conflict.

Using "restated" or "un-restated" 2009-10 data

1.21. The DPCR4 LRRM calculation and DPCR5 ALP calculation both require use of losses performance data for 2009-10. We published a decision document on 9 March 2012 allowing DNOs that could prove the existence of abnormal data cleansing activity, to restate their 2009-10 losses performance data. We need to decide whether, for the purposes of the DPCR4 LRRM and DPCR5 ALP, DNOs should use "restated" or "un-restated" 2009-10 data. This question is considered in more detail in Chapter 3.

2. Potential solutions to the conflict between the interaction adjustment and cap and collar

Chapter Summary

This chapter outlines the potential solutions to the conflict between the DPCR4 LRRM and the DPCR5 Cap and Collar.

Chapter Questions

Question 1: Which of the strengths and weaknesses we have suggested are most important to you as we consider options to resolve the conflict?

Question 2: Are there any strengths or weaknesses we have missed?

Question 3: What is your assessment of the options we have suggested? In providing your response, please also consider the extent to which any option moves away from the original intent of the DPCR5 settlement.

Question 4: Which is your preferred option for resolving the conflict and why?

Question 5: Are there any other options we should consider?

Potential Solutions

2.1. In Chapter 1, we set out how the interaction mechanism and the cap and collar operating in combination could lead to unintended outcomes. Through our analysis internally and engagement with stakeholders, we have identified five potential solutions to this issue:

1. Remove the interaction adjustment from the DPCR4 LRRM and introduce an annual interaction adjustment during DPCR5.
2. Remove the interaction adjustment from the DPCR4 LRRM and set 2009-10 performance as the target.
3. Remove the interaction adjustment from the DPCR4 LRRM and set 2010-11 performance as the target.
4. Introduce a cap and collar on the DPCR4 LRRM interaction amount.
5. Change the DPCR5 cap and collar amounts.

2.2. We now need to make an assessment of each and, in view of alternatives and responses to this consultation, decide how to proceed. Some of the factors we will consider in assessing the options include:

- whether the option upholds the purpose of the incentive mechanism (to incentivise a DNO to manage an efficient level of losses on the network),
- whether the option removes the potential for a DNO to incur a windfall loss or gain,
- the impact on the consumer (in line with Ofgem's principal objective to protect consumers and to do so by promoting effective competition in the electricity sector),
- the potential implementation timing implications of any particular option on the close out of DPCR4 and the target setting for DPCR5, and
- the need to treat all DNOs in an even-handed manner.

2.3. The options put forward for consultation are intended to address the conflict between the DPCR4 interaction adjustment and the DPCR5 cap and collar (the detail of each being set out in DPCR5 Final Proposals). As demonstrated in the high level impact assessment at Appendix 1, not correcting this conflict may result in DNOs being protected from c.£100m penalties during DPCR5 based on reported 2009-10 losses levels continuing. The impact cannot have been known by individual DNOs at the time of the DPCR5 development since 2009-10 data has only recently become available.

2.4. This outcome was clearly never intended by DPCR5 Final Proposals. The options put forward for consultation represent potential ways of bringing the current situation into line with what was intended by Final Proposals. Our view is that they do not represent a departure from the intended policy of the losses incentive. However, we acknowledge that implementation of the options may require clarification of, or changes to, the mechanics of how that intended policy is delivered. We further acknowledge that implementation may require a modification to DNO licence conditions.

2.5. We are consulting on the options in the context of these potential clarifications, changes or modifications. We are also seeking observations, views or concerns on the degree to which any option moves away from the original intention of the DPCR5 settlement.

2.6. The process to be adopted in order to implement any particular proposal will depend on precisely what it is that needs to be done (and may be influenced by responses to the consultation); and what needs to be done, will only be clear once the consultation is closed and we have come to final decisions. Where licence modifications are required, they will be undertaken in accordance with the procedure set out at s11A (etc.) of the Electricity Act 1989 (as amended).

Option 1 – Introduce an annual DPCR5 interaction adjustment

2.7. To address the conflict between the interaction adjustment and cap and collar, we could detach the interaction adjustment from the DPCR4 LRRM and instead, administer an interaction adjustment annually during DPCR5. The

annual interaction adjustment would be applied to DPCR5 incentive amounts before the limitations of the DPCR5 annual smoothing mechanism are applied.

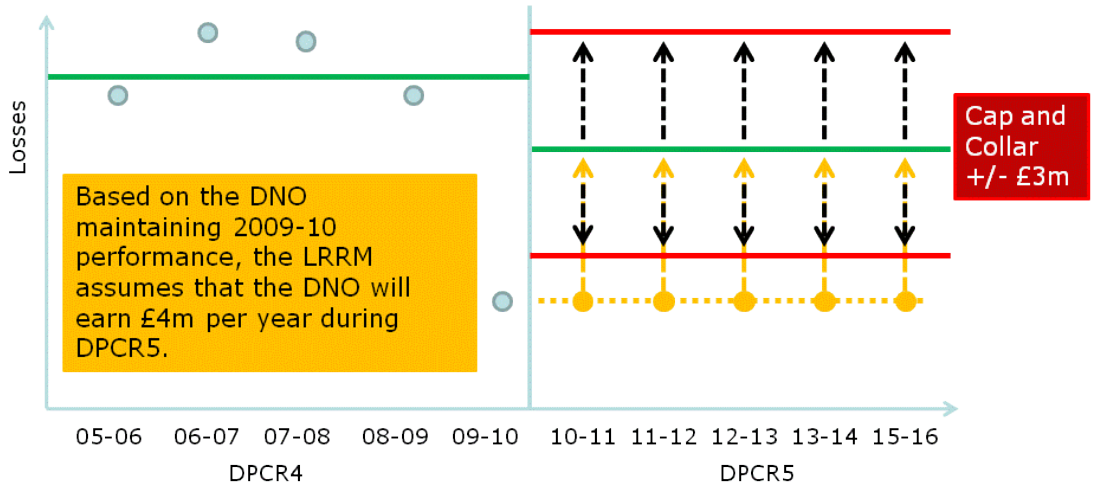

Figure 2.1: Example of how Option 1 could work

2.8. In this example, the interaction adjustment would be applied annually during DPCR5. The interaction adjustment would therefore claw back £4m each year during DPCR5. The annual thresholds (+/-£3m) would be applied to additional changes in performance.

2.9. Our suggested approach to delivering this option would be to remove the interaction adjustment from the DPCR4 LRRM set out in Chapter 4 of *DPCR5 Final Proposals – Financial Methodologies*:

Losses Rolling Retention Mechanism
$=5 \times \text{Incentive Rate} \times (TL_{2009\text{-}10} - ACL_{2009\text{-}10})$
$-\Sigma_{2005\text{-}06\ 2009\text{-}10}$ Losses Incentive
~~$-5 \times \text{Incentive Rate} \times (TL_{DPCR5} - ACL2_{2009\text{-}10})$~~

And to modify Special Licence Condition CRC7 to introduce an annual interaction adjustment to the DPCR5 annual distribution losses incentive amount (UILt), before the annual smoothing is applied:

$$UIL_t = [LR \times PIAL_{t-2} \times (AL_{t-2} - L_{t-2} \times [(1+I_t/100) \times (1+I_t\text{-}1/100)] - \text{Incentive Rate} \times (TL_{DPCR5} - ACL2_{2009\text{-}10})$$

2.10. Some of the key strengths and weaknesses of this option are outlined below:

Strengths	**Weaknesses**
There is no opportunity for DNO revenue loss or gain as a result of the conflict.	This solution would need to be implemented before we can issue a direction on the value of the PPL term.
This option would spread the	This solution could alter the DNOs' forecasted

financial impact of the interaction adjustment over five years, rather than two years, thus reducing volatility in DUoS charges.	allowed revenue for 2013-14 and 2014-15, as the interaction adjustment would be spread over five years rather than two years.
All DNOs would have an equal incentive to improve losses performance during DPCR5.	There could be a discrepancy between DNOs' reported performance against the DPCR5 ALP and the financial incentive amount that the DNO received.

Option 2 – Set 2009-10 performance as the DPCR5 target

2.11. Another option to address the conflict between the interaction adjustment and cap and collar is to set the 2009-10 losses performance (recalculated using the DPCR5 common methodology) as the DPCR5 target. This would mean there is no need for an interaction adjustment.

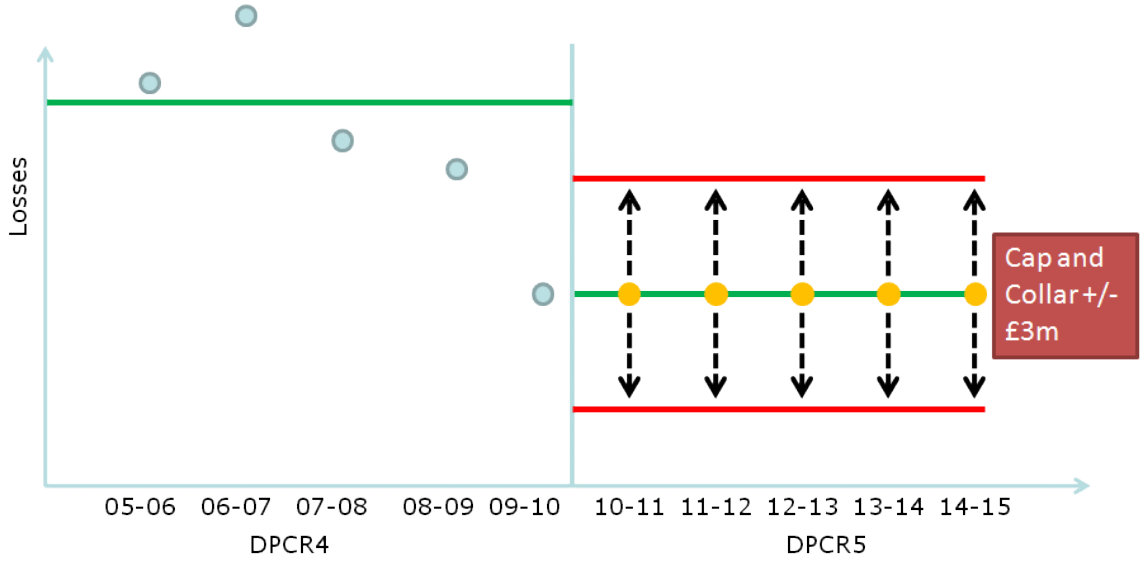

Figure 2.2: Example of how Option 2 could work

2.12. In this example the 2009-10 performance is set as the target for DPCR5. The annual thresholds (+/-£3m) are applied to additional changes in performance during DPCR5.

2.13. Our suggested approach to delivering this option would be to change the methodology used to calculate the DPCR5 ALP, as set out in 4.8 of *DPCR5 Final Proposals – Financial Methodologies*, so that it uses the Allowed Loss Rate (ALR) for 2009-10 only (and by implication, modify references to *Final Proposals* in Special Licence Condition CRC7.12):

$$ALP_{DPCR5} = \sout{(\Sigma_{2005\text{-}06\ 2009\text{-}10}} ALR_{2009\text{-}10} \sout{/5)} - S/UD_{2009\text{-}10}$$

2.14. Some of the main strengths and weaknesses of this option are outlined below:

Strengths	Weaknesses
No opportunity for revenue loss or gain as a result of th the conflict.	The DPCR5 target only takes into account losses in one year (2009-10).
All DNOs would have an equal incentive to improve losses performance during DPCR5.	This process would need to be complete before we issue a direction on the value of the PPL or ALP.
This option would effectively spread the impact of the interaction adjustment over five years, rather than two years.	This could alter the DNOs' forecasted 2013-14 and 2014-15 PPL amount, thus altering the DNOs' forecasted allowed revenue.

Option 3 – Set 2010-11 performance as the DPCR5 target

2.15. This option is a variant of Option 2 as a means of deactivating the interaction adjustment. If we set the 2010-11 losses performance as the DPCR5 target, then there would be no interaction between losses performance in DPCR4 and DPCR5 and therefore no need for an adjustment.

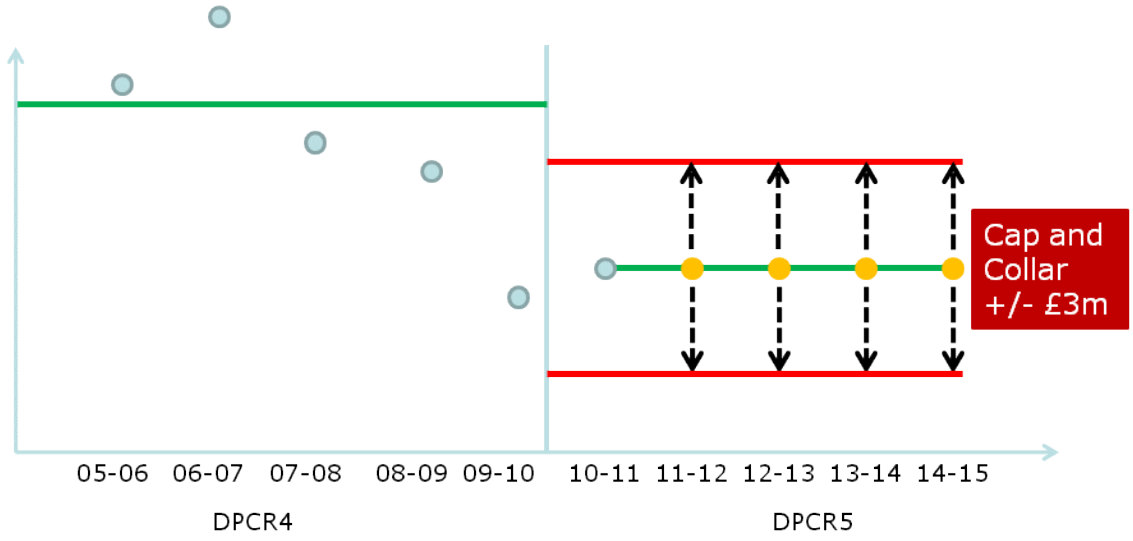

Figure 2.3: Example of how Option 3 could work

2.16. In this example, the cap and collar is applied to the DNOs 2010-11 performance. This deactivates the interaction adjustment, but also has the effect of turning off the losses mechanism in 2010-11. To implement Option 3 we could use common data to calculate the target and interaction adjustment, and set the target as the 2010-11 performance. This will automatically set the interaction adjustment to zero.

2.17. Our suggested approach to delivering this option would be to change the methodology used to calculate the DPCR5 ALP, as set out in 4.8 of *DPCR5*

Final Proposals –Financial Methodologies as follows (and by implication, modify references to *Final Proposals* in Special Licence Condition CRC7.12):

$$ALP_{DPCR5} = (\Sigma_{2005\text{-}06\ 2009\text{-}10} ALR_{2010\text{-}11} /5) - S/UD_{2010\text{-}11}$$

2.18. Some of the main strengths and weaknesses of this option are outlined below:

Strengths	Weaknesses
No opportunity for revenue loss or gain as a result of the conflict.	The DPCR5 target only takes into account losses in one year (2010-11).
All DNOs would have an equal incentive to improve losses performance during the final four years of DPCR5.	The implementation of this option would need to be complete before we issue a direction on the value of the PPL or ALP.
Setting the target during DPCR5 allows a longer lag beyond the abnormal data cleansing activity known to have affected 2009-10 data.	This could alter the DNOs' forecasted 2013-14 and 2014-15 PPL amount.
This option would effectively spread the impact of the interaction adjustment over four years, rather than two years.	The losses mechanism is effectively switched off for 2010-11, removing any rewards/penalties due to changes in performance from 2009-10.

Option 4 – Introduce a cap and collar to the LRRM interaction adjustment

2.19. Another option to address the conflict between the interaction adjustment and cap and collar is to apply restrictions (caps and collars) on the value of the DPCR4 interaction adjustment so that it reflects the DPCR5 Cap and Collar.

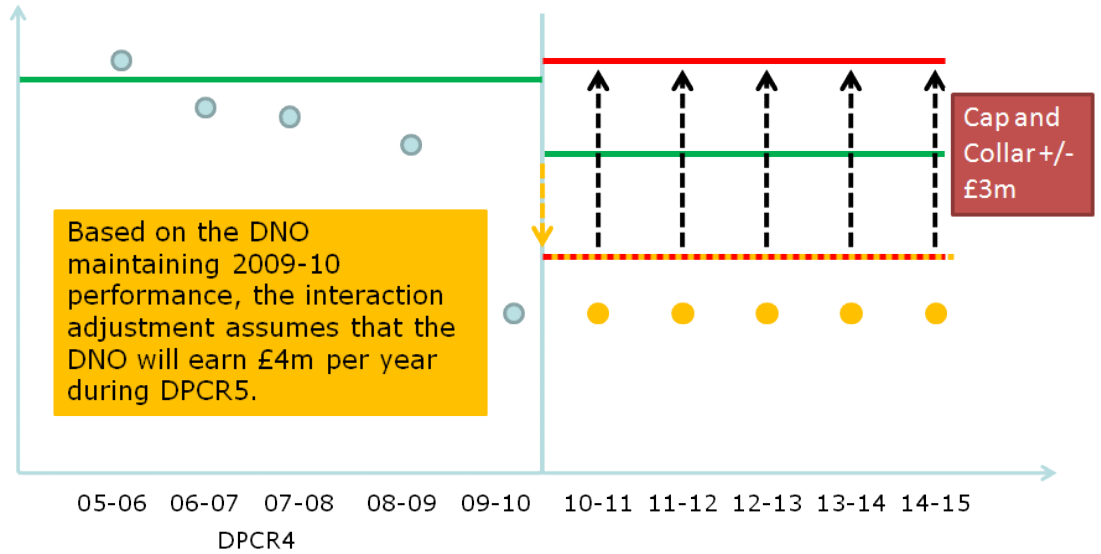

Figure 2.4: Example of how Option 4 could work

2.20. In this example, based on the DNO maintaining performance, the interaction adjustment assumes that the DNO will earn £4m per year during DPCR5 (£20m in total). The maximum revenue amount that the DNO can earn under the losses incentive during DPCR5 is £15m. The DNO's interaction adjustment is therefore collared at -£15m.

2.21. Our suggested approach to delivering this option would be to change *DPCR5 Final Proposals – Financial Methodologies* to limit the maximum incentive amount (reward or penalty) that a licensee can receive from the DPCR4 LRRM interaction adjustment, based on the DNOs' DPCR5 cap and collar amounts, referenced in Table 6.3 of *DPCR5 Final Proposals – Incentives and Obligations* (and by implication, modify references to *Final Proposals* in Special Licence Condition CRC7.8):

If $5 \times \text{Incentive Rate} \times (TL_{DPCR5} - ACL2_{2009\text{-}10}) \geq 0$ then

LRRM
$= 5 \times \text{Incentive Rate} \times (TL_{2009\text{-}10} - ACL_{2009\text{-}10})$
$-\Sigma_{2005\text{-}06\ 2009\text{-}10}$Losses Incentive
$- \min(5 \times \text{Incentive Rate} \times (TL_{DPCR5} - ACL2_{2009\text{-}10})),(\text{Cap})$

Or

If $5 \times \text{Incentive Rate} \times (TL_{DPCR5} - ACL2_{2009\text{-}10}) < 0$ then

LRRM
$= 5 \times \text{Incentive Rate} \times (TL_{2009\text{-}10} - ACL_{2009\text{-}10})$
$-\Sigma_{2005\text{-}06\ 2009\text{-}10}$Losses Incentive
$- \max(5 \times \text{Incentive Rate} \times (TL_{DPCR5} - ACL2_{2009\text{-}10})),(\text{Collar})$

2.22. Some of the main strengths and weaknesses of this option are outlined below:

Strengths	**Weaknesses**
No opportunity for DNO revenue loss or gain as a result of the conflict.	Asymmetrical revenue exposure for DPCR5 remains, thus potentially removing the incentive for some DNOs to reduce losses during DPCR5.
	This option could limit the incentive amount that the DNOs can earn under the DPCR4 losses incentive mechanism.
	The implementation of this solution would need to be complete before we issue a direction on the value of the PPL.
	This could alter the DNOs' forecasted allowed revenue for 2013-14 and 2014-15.

Option 5 – Change the DPCR5 Cap and Collar amounts

2.23. Another option to address the conflict between the interaction adjustment and cap and collar is to relax the restrictions of the DPCR5 cap and collar to minimise the possibility of DNO revenue loss or gain.

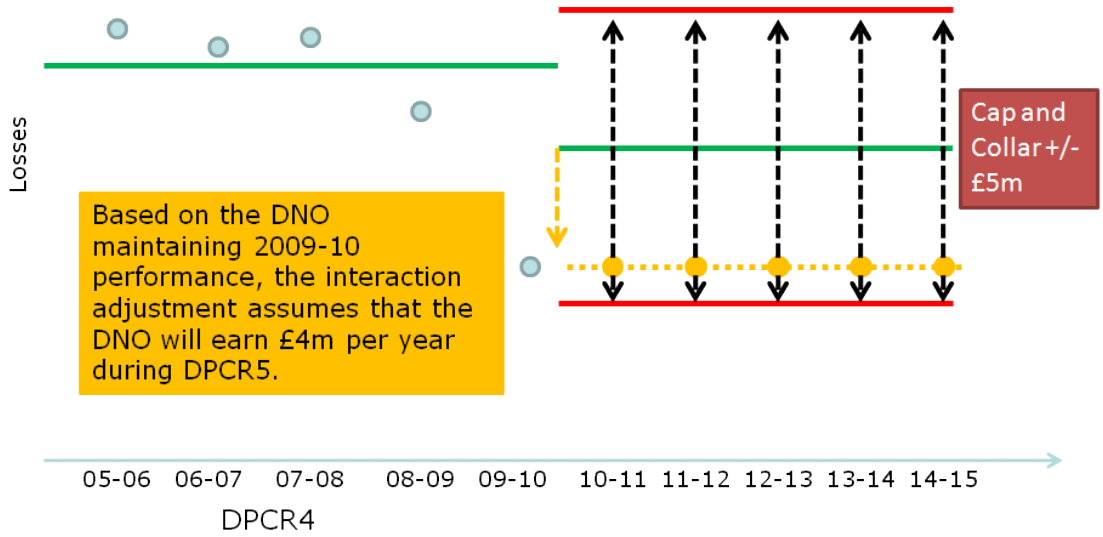

Figure 2.5: Example of how Option 5 could work

2.24. There are numerous approaches that we could use to revise the cap and collar values. In this example the interaction adjustment assumes that the DNOs will earn +£4m per year during DPCR5 (+£20m in total). To ensure that a DNO does not incur a windfall gain and had incentive to improve performance, the cap and collar are widened to +/-£5m per year during DPCR5 (+/-£25m in total). Taking interaction adjustment and DPCR5 annual performance into account the DNO would be eligible for a maximum reward of only £1m per year. This is regardless of whether its losses position improves, and compares with exposure to a potential annual penalty of £9m.

2.25. Our suggested approach to implementing this option we be to make a modification to Special Licence Condition CRC7 to alter the values of the DPCR5 annual upper and lower thresholds (the UT and LT terms) and reset the values set out in table 6.3 and 6.4 of Chapter 6 of the *DPCR5 Final Proposals - Incentives and Obligations* (Ref 145/09) .

2.26. Some of the main strengths and weaknesses of this option are outlined below:

Strengths	**Weaknesses**
Dependent on the size of the revised cap and collar, then there is potentially no opportunity for DNO revenue loss or gain from the interaction adjustment	All options to change cap and/or collar values will inevitably result in a widening of the gap between them, increasing exposure for DNOs and potential volatility for suppliers. This increased risk

	of volatility in DNO allowed revenue position would result in increased risk of volatility in customers' DUoS charges.
There are no interdependencies with the calculation of the DPCR4 LRRM and DPCR5 ALP.	Asymmetrical revenue exposure for DPCR5 remains, thus potentially removing the incentive to reduce losses during DPCR5 for some DNOs.
	This option does reduces certainty on the DNOs allowed revenue position and DUoS charges during DPCR5.

Conclusions

2.27. On the basis of our assessment against the factors outlined in section 2.2 and the Impact Assessment at Appendix 1, we currently consider that options 1, 2 and 3 would be more effective than options 4 and 5. All three options are intended to resolve the conflict between the interaction adjustment and the cap and collar without exposing suppliers and their customers to more volatility in DUoS charges. They also appear to remove the potential for DNO revenue loss or gain and provide an equal, proportionate incentive to improve losses performance. We are keen to understand the views of respondents, including their assessment of the options and reasons for any preferred approach, supported by appropriate evidence.

3. Data to be used for the DPCR4 LRRM and DPCR5 ALP

Chapter Summary

This chapter considers which data sets should be used to calculate the DPCR4 LRRM and DPCR5 ALP for those DNOs that are permitted to restate their 2009-10 losses positions following abnormal levels of corrections made to settlement data.

Questions 6 to Question 12 of this consultation are embedded in the text of this Chapter to assist with reading. Please provide any evidence and analysis you consider necessary in responding to these questions. A full summary of all questions is included at Appendix 2 of this document.

Background

3.1. Losses performance is measured by deducting the number of units of electricity distributed from the number of units entering the distribution network. In 2010 a number of DNOs noted an abnormally high level of corrections being made to settlement data. This had the effect of reducing the number of units distributed and increasing the perceived level of losses on their network for that year.

3.2. Following consultation and engagement with stakeholders we published a decision letter on 9 March 2012 to address the effects of settlement data corrections. As part of this decision, we confirmed that DNOs may be able to restate their 2009-10 annual losses reporting data if they can demonstrate that an abnormal level of settlement data adjustments has occurred. We also provided details of statistical tests and guiding principles to be applied to any restatement application.

The 2009-10 data that would currently be used

3.3. Losses data for 2009-10 is used in four circumstances:

i. To calculate the 2009-10 losses "annual incentive value";
ii. As part of the DPCR4 LRRM "the five times E" component;
iii. As part of the DPCR4 LRRM "interaction adjustment"; and
iv. To calculate the DPCR5 ALP.[6]

[6] The current methodology to calculate the DPCR4 LRRM and DPCR5 ALP are specified in Chapter 4 of DPCR5 *Final Proposals – Financial Methodologies* and reproduced in Chapter 1 of this document.

3.4. For DNOs whose 2009-10 performance data is not restated (ie because they do not apply or because their application is not justified), there will be no change to the position set out in Final Proposals. But for DNOs who are allowed to restate their 2009-10 losses performance data, we need to decide whether they should use the "restated"[7] or "un-restated"[8] 2009-10 value. This chapter considers the options.

3.5. If we were to adhere to the DPCR4 LRRM and DPCR5 ALP methodology (as set out in the *DPCR5 Final Proposals*), we consider that the DNOs who have restated their 2009-10 losses performance would be currently required to use figures as set out in Table 1 below.

	Restated	Un-restated	Reporting methodology
i. Annual Incentive	x		DPCR4
ii. LRRM "Five times E" component	x		DPCR4
iii. LRRM Interaction Adjustment		x	DPCR5
iv. DPCR5 ALP		x	DPCR5

Table 1: Status quo for use of 2009-10 performance data

3.6. The figures in the "Five times E" component are drawn directly from 2009-10 revenue reporting during DPCR4 and therefore restated data will be used where restatement has been approved. *DPCR5 Final Proposals* also make clear that the 2009-10 units distributed that are used in the interaction adjustment and the DPCR5 ALP, are based on DPCR5 common methodology reporting. The automatic position, therefore would be the use of un-restated data for these calculations. The key question for each component, as discussed in the sections that follow, is whether we should move away from the position above set out in Table 1, above.

3.7. These issues were initially considered as part of our October 2011 consultation. However at the time, little was understood about the conflicts between the interaction adjustment and cap and collar that are considered in Chapter 2. There are links between the options in Chapter 2 and the question of whether to use "restated" or "un-restated" 2009-10 data. We therefore consider it is right to allow respondents a further opportunity to assess the options where decisions have not already been made.

[7] When we refer to "restated data" we are referring to the revised 2009-10 reported figures after adjustment/normalisation through application of the agreed methodology.
[8] When we refer to "un-restated data" we are referring to the original 2009-10 reported figures at RF (ie including all data corrections).

Whether to use "restated" or "un-restated" 2009-10 data

Annual Incentive Value and DPCR4 LRRM "Five times E" component

3.8. The Annual Incentive Value is the amount of incentive a DNO will be rewarded/penalised based on its losses performance each year. The "Five times E" component of the LRRM ensures that sustainable improvements in losses performance are rewarded equally, irrespective of when they are undertaken within the DPCR4 period. To achieve this DNOs are rewarded five times their losses performance in 2009-10 (less rewards/penalties received/incurred for units distributed after 1 April 2005 under the losses incentive mechanism during DPCR4)[9].

3.9. As set out in the 9 March 2012 decision document, referred to in paragraph 3.2, we consider that sufficient evidence exists that abnormal levels of settlement data corrections have occurred in some distribution areas, such that reported 2009-10 data are deficient in reflecting the performance of some licensees for the purposes of adjusting allowed revenue. Further, we consider that allowing applications to restate 2009-10 reported losses data is necessary to give the opportunity to restore allowed revenue positions to the proper level.

3.10. Our decision of 9 March 2012 means that the Annual Incentive Value would use restated 2009-10 data where restatement is approved. For clarity, we consider that the rationale behind the 9 March decision (and the use of restated data for the Annual Incentive Value) applies equally to the "Five times E" component of the DPCR4 LRRM calculation. As such, we are not proposing to move away from the position set out in Table 1. We do not consider this position constitutes a change of policy and plan to make this explicit in a decision document that will follow this consultation period.

3.11. We have been contacted by stakeholders requesting clarification of the calculation of the incentives over DPCR4 for the means of the LRRM calculation[10], regarding whether nominal or RPI-indexed values should be used. We would welcome your views on this matter.

Question 6: Do you think that nominal or RPI-indexed values for incentives over DPCR4 should be used in the LRRM calculation? And do you have any other views on the Five times E component?

[9] The methodology for calculating the "five times E" (5xE) component of the LRRM is outlined in DPCR5 Final Proposals and replicated in Chapter 1 of this document.
[10] "Σ incentive over DPCR4" in Final Proposals.

Interaction Adjustment

3.12. The primary purpose of the interaction adjustment is to ensure that no DNO is penalised/rewarded twice for the same losses performance[11]. As in Table 1 above, we consider that DNOs are currently required to use un-restated data for the interaction adjustment calculation. The question is whether it is necessary to change this position and instead require DNOs (who are allowed to restate 2009-10) to use the restated version of ACL2.[12]

3.13. In paragraph 5.9 of the October 2011 consultation and a subsequent note of clarification, we proposed using the restated 2009-10 losses data (re-reported using the DPCR5 common methodology) to calculate the interaction adjustment. Responses to this proposal were mixed. The key point that the respondents disagreed on was how losses performance would change between 2009-10 and DPCR5. More specifically, the question is what impact the abnormal levels of corrections to settlements data would have on DNOs future losses positions, and whether reported losses would remain at 2009-10 un-restated levels or return to the lower levels seen prior to the corrections activity (ie reflecting a restated position).

3.14. Understanding this point is crucial in terms of assessing the impact of using either a restated or un-restated ACL2 value. We consider here four possible scenarios which may affect DNOs differently. The appropriate operation of the interaction adjustment hinges on which of these scenarios best reflects reality. Scenarios are shown in the table and charts below[13]:

Scen.	Level of DPCR5 losses	Data used to calculate the interaction adjustment	Result
1	Continues at un-restated 2009-10 levels	Restated 2009-10 data	DNO incurs a windfall loss
2	Continues at restated 2009-10 levels	Restated 2009-10 data	Interaction Adjustment operates as intended
3	Continues at un-restated 2009-10 levels	Un-restated 2009-10 data	Interaction Adjustment operates as intended
4	Continues at restated 2009-10 levels	Un-restated 2009-10 data	DNO incurs a windfall gain

Table 2: Scenarios for DPCR5 losses peformance

[11] The methodology for calculating the interaction adjustment is specified in *DPCR5 Final Proposals* and replicated in Chapter 1 of this document.
[12] Delivering a change to the ACL2 figure would in fact be achieved by using the restated value of $UD_{2009\text{-}10}$. That is to say, that no change is required to ACL2 itself, since it is only the result of taking Units Distributed in 2009-10 ($UD_{2009\text{-}10}$) away from the number of units entering the distribution network in that year.
[13] The scenarios presented are theoretical and assume non-changing losses performance from 2009-10 onwards. The 2009-10 data point linked by the red line represents that used to calculate the interaction adjustment in each scenario.

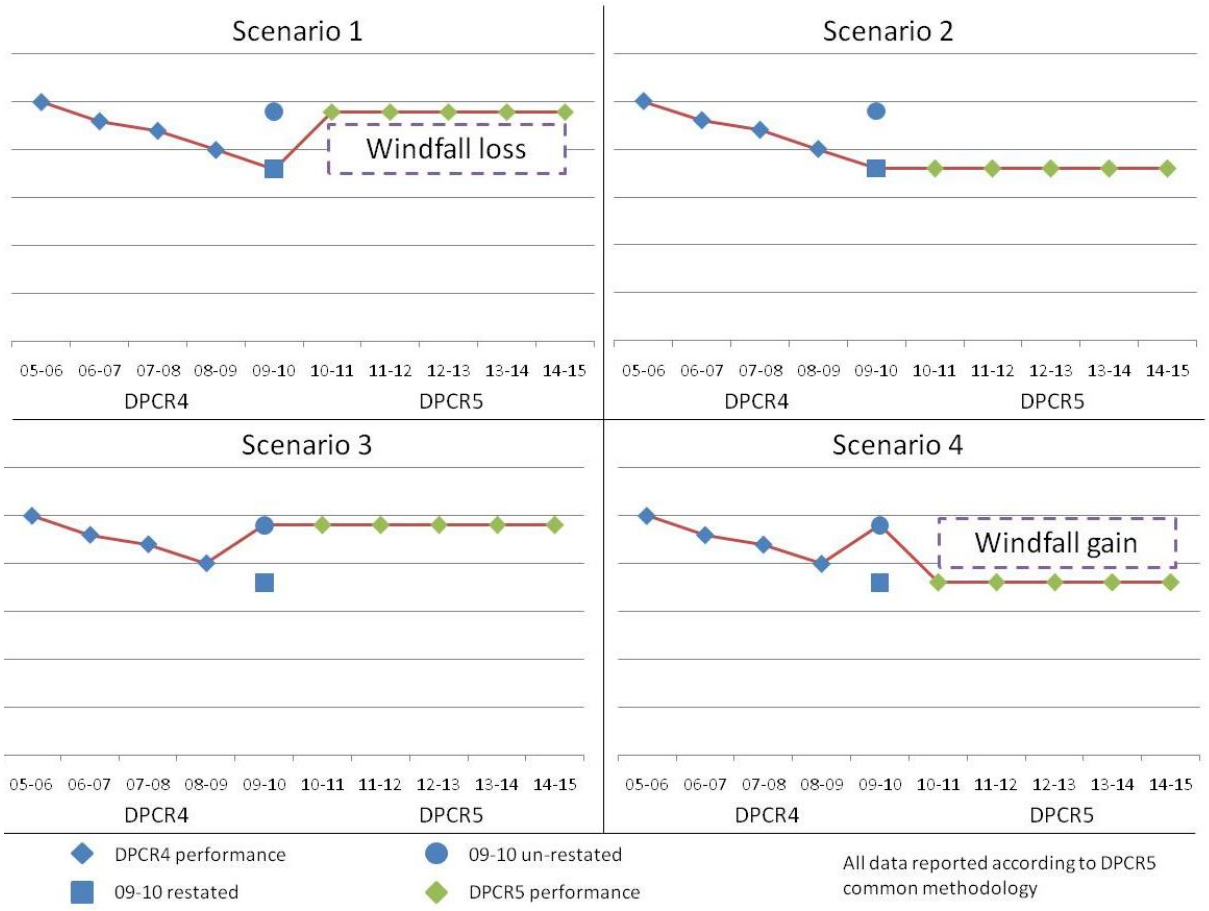

Figure 3.1: Scenarios for DPCR5 losses performance

3.15. We already have reasonably up-to-date information from DNOs on RF positions for 2010-11, though we would be keen to see data for the month or two since our previous request. However, in considering whether we should require use of a restated or un-restated ACL2, we would like to understand the views of stakeholders on whether losses positions would be likely to increase, remain at the 2009-10 un-restated levels or return to levels prior to 2009-10.

Question 7: What are your views on the reasons why losses positions might increase, remain at 2009-10 levels or reduce? What bearing should this have on the decision about whether DNOs should use a restated or un-restated ACL2 figure? Please provide evidence or analysis you consider necessary to support your position.

3.16. The operation of the interaction adjustment is also affected by some of the options under consideration in Chapter 2, as summarised in the table below.

Cap and Collar Options	Impact on data used to calculate the interaction adjustment
Option 1 – Introduce an annual DPCR5 interaction adjustment	Interaction adjustment value is annual. The derivation of the total interaction adjustment still depends on whether or not ACL2 is restated.
Option 2 – Set 2009-10 performance as the DPCR5 target	The interaction adjustment is set to zero provided the data to used to calculate ACL2 is consistent with used to calculate the ALP (ie both are restated or both are un-restated).
Option 3 – Set 2010-11 performance as the DPCR5 target	As for Option 2.
Option 4 – Introduce a cap and collar to the LRRM interaction adjustment	A cap and collar is applied to the interaction adjustment. The derivation of the interaction adjustment still depends on whether or not ACL2 is restated.
Option 5 – Change the DPCR5 Cap and Collar amounts	No impact: the derivation of the interaction adjustment still depends on whether or not ACL2 is restated.

Question 8: Do the options put forward for Chapter 2 have any bearing on question of whether to use a restated or un-restated ACL2?

Question 9: Should we use a restated or un-restated ACL2 for calculating the DPCR4 LRRM Interaction Adjustment?

DPCR5 Allowed Loss Percentage (ALP)

3.17. In each price control we set each DNO a losses target as an annual allowed losses percentage (ALP) for the price control period. If a DNO's percentage losses exceeds the ALP then they incur a penalty, and if their losses percentage is lower than the ALP then they receive a reward.

3.18. For the DPCR4 price control the ALP was a fixed five year target, based on average performance during the ten years to 2002-03. DPCR5 Final Proposals explain the derivation of the DPCR5 target, which is fixed for five years, based on average performance during DPCR4 and recalculated using the DPCR5 common reporting methodology. The methodology used to calculate the DPCR5 ALP is outlined below.

$$ALP = (\Sigma_{2005\text{-}06\ 2009\text{-}10} ALR_t/5) - S/UD_{2009\text{-}10}$$

Where:
ALP_t = allowed loss percentage
$ALR_t = RL_t/UD_t$
UD_t = units distributed (GWh), recalculated using DPCR5 common methodology
RL_t = the losses in GWh, recalculated using DPCR5 common methodology
S = forecast DPCR5 annual level of substation electricity usage (GWh)

3.19. A decision on whether to use restated or un-restated 2009-10 losses data in the calculation of the DPCR5 losses target is also required. As in Table 1 above, if we did nothing DNOs would be required to use un-restated 2009-10 values for the DPCR5 ALP. The question is whether to instead require DNOs to use restated 2009-10 values for calculating the DPCR5 ALP.[14]

3.20. In our October 2011 consultation we proposed that, for those DNOs that are allowed a restatement of their 2009-10 data, it may be appropriate to use the un-restated 2009-10 losses data to calculate the target for DPCR5. Some responses questioned why this was appropriate, if this data was considered deficient to reflect 2009-10 losses performance. We note that we have given DNOs the opportunity to demonstrate that un-restated data was deficient for the purposes of calculating the 2009-10 incentive because of a material difference in the data used to calculate the annual incentive compared with the basis on which the DPCR4 target was set.

3.21. Other respondents noted that (in line with the restrictions of the Balancing and Settlements Code) settlement data adjustments can only be made to correct for genuine errors in settlement data. It could therefore be argued that the adjustments that affected 2009-10 settlement data have made losses reporting more accurate going forward. These stakeholders considered that as these are valid corrections to settlement data (albeit possibly not in the corresponding settlement period) it may be valid to include them in the calculation of losses targets for the next price control.

3.22. Some respondents were concerned that if corrections made to settlement data were made to correct errors for years prior to DPCR4, then this could inflate the average losses over DPCR4, and therefore inflate the target for DPCR5. Despite extensive engagement, stakeholders have not been able to provide any detailed evidence of which years' settlement data adjustments were compensating for.

3.23. The DPCR5 ALP is an integral consideration in all of the options in Chapter 2 of this consultation document. However, the question of whether to use restated or un-restated 2009-10 data for the DPCR5 ALP does not affect the operation of the options, apart from Option 2. Option 2 calculates the DPCR5 ALP based on the 2009-10 data only. If 2009-10 data contains compensatory settlement data adjustments for other years, then the ALP could be over-stated.

Question 10: Do you think we should use restated or un-restated 2009-10 data for the purposes of calculating the DPCR5 target? Please consider your response to the previous question and to questions in Chapter 2 of this document in responding?

[14] Delivering a restated version of the DPCR5 ALP would in practice mean requiring DNOs to use restated values for $UD_{2009\text{-}10}$ and consequently $RL_{2009\text{-}10}$. It is worth noting that $RL_{2009\text{-}10}$ is exactly the same as $ACL_{2009\text{-}10}$ as is used in the DPCR4 LRRM interaction adjustment, that is to say, losses (GWh) reported using the DPCR5 methodology.

Restating 2009-10 data using the DPCR5 common methodology

3.24. The options presented above include restating units distributed in 2009-10 according to the common DPCR5 methodology ($UD_{2009\text{-}10}$). In the October 2011 consultation we sought views on the process for achieving this but the views we received were mixed and inconclusive. We are therefore seeking further comment on this process and have two initial proposals:

- Apply the agreed restatement methodology ("SP methodology") to 2009-10 data, reported under the DPCR5 common methodology.

- Apply the same percentage increase to non-half-hourly units distributed in 2009-10 under the DPCR5 methodology ($UD_{2009\text{-}10}$) as that resulting from successful restatement of 2009-10 data under the DPCR4 methodology.

3.25. Depending on precisely how they are implemented, these options may represent a clarification or change in policy or a licence modification. This is because the methodology set out in DPCR5 Final Proposals did not anticipate having to use restated 2009-10 data under the DPCR5 common methodology.

Question 11: Do you think either of these two options may successfully be used to restate units distributed in 2009-10 under the DPCR5 methodology? Can you offer an alternative method? Which method should be used for restating $UD_{2009\text{-}10}$?

Implementation

3.26. In considering the restatement of $UD_{2009\text{-}10}$, we recognise that to use restated data for ALC2 and at the same time un-restated data for ALP, or vice versa, would require use of different values of $UD_{2009\text{-}10.}$ As with the issues considered in Chapter 2 of this document, implementation of some of the proposals throughout this Chapter may require clarification or changes to the detail of what was set out in *DPCR5 Final Proposals* and/or may require modification of DNO licence conditions. The approach we take to implementing the options will depend on our final decision.

Question 12: Alongside your consideration of whether to use restated or un-restated 2009-10 data, we are seeking views on the degree of any departure from the DPCR5 settlement and any observations or concerns you may want to share with us.

Appendix 1 - Impact Assessment

1. Under section 5A of the Utilities Act 2000, subject to certain exceptions, we are required to carry out an impact assessment where we consider a proposal to be "important" within the meaning of that section.

2. Whilst it is too early to form a definitive view, we consider that the proposals under consideration in Chapter 2 could fall within the definition of what is important under the Act. We have therefore undertaken this Impact Assessment upon which we are now consulting through this consultation document in accordance with the provisions of s5A(8) of the Utilities Act.

3. Chapter 3 considers datasets used to calculate the DPCR4 LRRM and DPCR5 ALP. We do not consider that an impact assessment is appropriate for these options as they are simply means of giving effect to the policy intention already consulted on as part of DPCR5. The policy rationale for the different options is set out in Chapter 3 of this document.

4. This appendix considers the costs, benefits and potential impact of the options discussed in Chapter 2 of this document and seeks stakeholder views on the matters raised herein.

Key objectives and summary

5. Our impact assessment has been informed by two key objectives of the policy options to address the conflict between the DPCR4 interaction adjustment and the DPCR5 cap and collar are to ensure that:

    - All licensees are incentivised to improve losses performance during DPCR5.
    - No licensee incurs a windfall loss or gain.

6. The do nothing option may result in DNOs being protected from c.£100m penalties during DPCR5 based on 2009-10 losses continuing. While all of the options remove this potential windfall gain, Options 4 and 5 do not guarantee the removal of asymmetrical revenue exposure and potentially limit incentives to DNOs to improve performance. Options 1, 2 or 3 best limit the potential impacts by removing the opportunity for windfall loss or gain and ensuring that loss reduction incentives are maintained.

Policy options

7. The consultation sets out options for resolving the conflict between the DPCR4 interaction adjustment and DPCR5 cap and collar:

    1. Remove the interaction adjustment from the DPCR4 LRRM and introduce an annual interaction adjustment during DPCR5.
    2. Set 2009-10 performance as the target.
    3. Set 2010-11 performance as the target
    4. Introduce a cap and collar on the DPCR4 LRRM interaction amount.
    5. Change the DPCR5 cap and collar amounts.

8. We have modelled the potential impact of these options on aggregate revenues from the losses incentive mechanism for DNOs[15]. For simplicity, we have assumed that the 2009-10 data used to calculate the interaction adjustment and targets is un-restated. We have also assumed that this un-restated performance continues at the same level throughout DPCR5. We have excluded the DPCR5 LRRM from our calculations.

Option	Impact of conflict on DNO revenues during DPCR5
Do nothing	DNOs receive c.£200m in the interaction adjustment, but penalties during DPCR5 are capped at c.£100m. DNOs are protected from a potential penalty of c.£100m. Asymmetrical revenue exposure may further reduce incentives to improve losses performance.
Option 1	The interaction adjustment can be recouped in full during DPCR5 so the net revenue impact is zero. Symmetrical revenue exposure incentivises improvements to losses performance.
Option 2	The interaction adjustment is set to zero and the cap and collar operates as intended. The net revenue impact is zero. Symmetrical revenue exposure incentivises improvements to losses performance.
Option 3	As for Option 2 but with no opportunity for incentives in 2010-11. Symmetrical revenue exposure incentivises improvements to losses performance.
Option 4	The interaction adjustment is capped at c.£100m, all of which can be recouped through penalties during DPCR5. The net impact is zero but with incentives of c.£100m from the interaction adjustment foregone. Asymmetrical revenue exposure may further reduce incentives to improve losses performance.
Option 5	The collar on penalties is expanded so that the c.£200m interaction adjustment can be fully recouped in penalties during DPCR5, so the net impact is zero. Depending on the design, asymmetrical revenue exposure reduces incentives to improve losses performance.

9. The following sections consider the impact of these options in more detail.

Impacts on consumers

- If we do nothing, then the DNOs could receive a windfall revenue gain of c.£100m. This windfall revenue gain in the DNOs' allowed revenue position may be funded by an increase in use of system charges of around £20m per year, and consequently consumers may experience a rise in their bills[16]. Increases in final bills are likely to put undue pressure on consumers, given the current economic climate.

[15] Based on latest information made available to Ofgem. All costs are estimates and are reported in 2009-10 prices.
[16] If this increase in charges is passed on in full it would amount to less than £1 per household per year.

- The do nothing option along with options 4 and 5 may result in DNOs having no incentive to improve losses performance during DPCR5, which could lead to increased losses during DPCR5. To compensate for increased losses, additional energy needs to be generated, creating an additional cost to consumers (and an adverse environmental impact through the consumption of fuel in generation that would otherwise have been avoided and through the release of additional greenhouse gases).

- The cap and collar amounts were set to provide DNOs with a proportionate incentive to improve performance and protect consumers from unnecessary volatility in their energy bills. If we change the cap and collar amounts, as under Option 5, then this exposes suppliers to additional volatility in their DUoS charges; that volatility may be passed on to consumers through their energy bills.

- The do nothing option results in the cost of the interaction adjustment being spread over two years. Options 1, 2 and 3 effectively detach the cost of the interaction adjustment from the LRRM and apply it annually during DPCR5, so the cost will be spread over five years, rather than two years. This should mean that suppliers and consumers experience less volatility in the costs of distribution due to the interaction adjustment than in the current arrangements.

Impacts on competition (including effects on small businesses)

- DNOs do not compete directly with one another in the provision of electricity networks.

- In making our decision, we are required to take into account our principal objective under s3A of the Electricity Act 1989 which, in summary, is to protect the interests of existing and future consumers in relation to electricity and to carry out our functions in a manner by promoting effective competition in the generation, transmission, distribution or supply of electricity. In the context of this decision we are specifically required to carry out our functions in a manner that we consider is best calculated to promote efficiency and economy on the part of DNOs and the efficient use of electricity conveyed by distribution systems.

- Our decision may have more of an effect on competition in the supply market. This is because decisions will affect DNOs differently depending on their closing DPCR4 losses positions in relation to the DPCR5 target. This will inevitably mean that certain suppliers face higher DUoS charges than others. While it is feasible that this may affect a supplier's market position, the limited impact on individual consumers (as highlighted above) should equally limit the impact on suppliers. Though option 5 may increase suppliers' exposure to changes in losses performance and DUoS charges, the impact will be felt by all and should therefore not significantly affect any one supplier's ability to compete as compared to another.

- Market participants, suppliers in particular, rely on a certain level of stability and certainty to ensure they are able to effectively plan ahead and attract/maintain appropriate levels of investment. Each of these options would alter the DNOs' forecasted allowed revenue over the next five years. This is likely to reduce

regulatory and financial certainty. The reduction of certainty is likely to hinder current and potential participants' ability to plan ahead and therefore increase barriers to entry and expansion.

Impacts on the environment (and sustainable development more generally)

- We have designed the distribution losses incentive mechanism to incentivise the reduction of losses on the distribution network. This contributes to Ofgem's objective to have regard to the need to contribute to the achievement of sustainable development. In particular, the mechanism seeks to contribute to three of Ofgem's sustainable development themes: reducing carbon emissions, promoting energy savings and ensuring a secure electricity supply. The main impact on sustainable development of this decision is the extent to which the mechanism continues to incentivise investment in loss reduction activities, at a time when distribution losses are estimated to contribute around 1.5 per cent of GB greenhouse gas emissions.

- The do nothing option, along with Option 4 and Option 5 may result in there being no incentive for DNOs to improve losses performance during DPCR5, potentially resulting in increased losses during DPCR5. To compensate for increased losses, additional energy needs to be generated, increasing levels of greenhouse gas emissions. It is difficult to calculate to what extent losses performance would change as a result of the options and, consequently, how emissions of greenhouse gasses would be affected, but a 1 percent increase in the current level of total distribution losses would equate to roughly 97,000 tonnes of CO_2 per annum or 7,000 tonnes per DNO.

- Minimising losses on the distribution network is also an important component of ensuring secure and reliable electricity.

Impacts on health and safety

- We do not consider there to be an impact on health and safety.

Post-implementation review

- DNOs are required to report losses performance annually. Following the implementation of the chosen solution, Ofgem would monitor industry performance against the losses incentive as part of its usual monitoring processes.

Conclusion

10. In relation to Chapter 2 of this document, we currently believe that options 1, 2 and 3 would be more appropriate than options 4 and 5. We are seeking the views of stakeholders in Chapter 2 of this consultation.

11. As stated in paragraph 3 of this Appendix, we do not consider that an impact assessment is appropriate for the issues raised in Chapter 3 of this document; hence no conclusions are provided at this stage.

Appendix 2 - Summary of questions

CHAPTER 2

Question 1: Which of the strengths and weaknesses we have suggested are most important to you as we consider options to resolve the conflict?

Question 2: Are there any strengths weaknesses we have missed?

Question 3: What is your assessment of the options we have suggested? In providing your response, please consider the extent to which any option moves away from the original intention of the DPCR5 settlement.

Question 4: Which is your preferred option for resolving the conflict and why?

Question 5: Are there any other options we should consider?

CHAPTER 3

Question 6: Do you think that nominal or RPI-indexed values for incentives over DPCR4 should be used in the LRRM calculation? And do you have any other views on the 5 times E component?

Question 7: What are your views on the reasons why losses positions might increase, remain at 2009-10 levels or reduce? What bearing should this have on the decision about whether DNOs should use a restated or un-restated ACL2 figure? Please provide evidence or analysis you consider necessary to support your position.

Question 8: Do the options put forward for Chapter 2 have any bearing on question of whether to use a restated or un-restated ACL2?

Question 9: Should we use a restated or un-restated ACL2 for calculating the DPCR4 LRRM Interaction Adjustment?

Question 10: Do you think we should use restated or un-restated 2009-10 data for the purposes of calculating the DPCR5 target? Please consider your response to the previous question and to questions in Chapter 2 of this document in responding?

Question 11: Do you think either of these two options may successfully be used to restate units distributed in 2009-10 under the DPCR5 methodology? Can you offer an alternative method? Which method should be used for restating $UD_{2009\text{-}10}$?

Question 12: Alongside your consideration of whether to use restated or un-restated 2009-10 data, we are seeking views on the degree of any departure from the DPCR5 settlement and any observations or concerns you may want to share with us.

Appendix 3 - 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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