RWE npower

Lesley Ferrando
Ofgem
9 Millbank
London
SW1P 3GE

Your ref
Name Helen Inwood
Phone 07795 354788
Fax 0121 336 5250
E-Mail Helen.Inwood@npower.com

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Dear Lesley

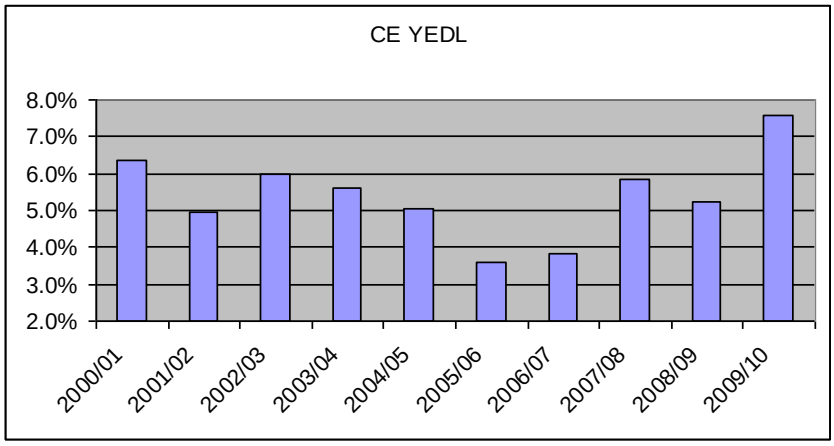
Consultation on regulatory measures to address the effects of gross volume correction and other settlements data adjustments on the distribution losses incentives mechanism.

RWE npower welcomes the opportunity to comment on these proposals. This response is provided on behalf of the RWE group of companies, including RWE npower plc, RWE Supply and Trading GmbH and RWE npower Renewables Limited, a fully owned subsidiary of RWE Innogy GmbH.

We have answered the specific questions in the consultation below. However, we have a number of fundamental concerns regarding this whole process that we do not believe have been addressed by Ofgem. We would like to outline these concerns separately before answering the individual questions within the consultation:

Losses during the DPCR4 Period

GVC corrects settled volume for the whole period of supply. It has been established that the application of GVC was one of the factors which caused the number of units reported as distributed in 2009/10 to be depressed. This resulted in an observed increase in calculated losses for 2009/10. This can be seen on the graph below for YEDL, one of the DNOs areas who have already received restatement of units.



RWE npower
2 Princes Way
Solihull
West Midlands
B91 3ES

Registered office:
RWE Npower plc
Windmill Hill
Business Park
Whitehill Way
Swindon
Wiltshire SN5
6PB

Registered in England and Wales no.

While the application of GVC in 2009/10 had a detrimental impact on calculated distribution losses, it is important to recognise that the DNO would previously have had the benefit of the overstatement of units in the period for which GVC was correcting. Looking at the graph above, it is apparent that in the YEDL area, losses in 2005/6 and 2006/7 were significantly lower (and probably technically impossible?) - 3.6% and 3.8% respectively than in previous or later years. The average for DPCR4 period is 5.2% with losses over the 10 year period tending to be between 5%-6%. The very low losses that were observed in 2005-2007 for YEDL were not questioned and the DNO automatically received the benefit of lower than average losses for that period. Ofgem have stated that they believe GVC was carried out to correct errors mainly in recent years (Para 2.6 of the consultation). This aligns with the graph below, showing that YEDL received benefit of distributed units being overstated in a 2005-2007 but this was corrected using GVC in 2009/10.

This pattern of lower losses in other periods is also observed in other DNO areas.

We would strongly argue that if 2009/10 adjustments are to be made, other years where the DNO has accepted the benefits due to volume data being overstated should also be reopened. If this does not happen, the DNOs are receiving windfall gains over the DPCR4 period which, ultimately, will be passed through to consumers.

Price Control Agreements

As raised to Ofgem through the losses working group last year, DNOs and suppliers alike have concerns that the losses mechanism is not fit for purpose and will lead to windfall gains or losses for DNOs. There is little incentive for DNOs to invest in managing their losses since much of the data movement is outside of their control. However, it is important to recognise that the DNOs formally agreed to the terms of the losses methodologies and the Losses Rolling Retention Mechanism. However, what we have observed during the course of DPCR4 is that when the outturn has been significantly less, the DNOs have been happy to accept the rewards. When outturn has been greater than the target, the mechanism and the penalties have been queried by some DNOs. It does not seem reasonable that corrections to data are taking place in one direction only. Any changes should be applied to lower than expected data as well as higher than expected data.

Negative EACs

While we do not believe an adjustment should be made for 2009/10 for the reasons given above, we would like to comment specifically on the treatment of negative EACs. This is a fundamental principal in the CE methodology (adjustments of 25 GWh NEDL, 34 GWh YEDL, 52 GWh ENW). This adjustment is in addition to the normalisation process carried out i.e. the data is 'corrected' on a top down approach and then adjusted again on a bottom up process. This is a concern since it appears that adjustments to 'correct data' have been carried out twice. In addition, this approach is one-sided since it does not take account of large positive EACs.

Use of the P222 report is flawed because it does not take account of the start date on the EAC value. We wish to highlight again that **we do not believe that negative EACs are a significant issue**. We have recently received a list of npower mpans which were included in the Northern Powergrid adjustment in December 2010. We have analysed 50 mpans on one npower identifier and only 10 still have outstanding negative EACs going into settlements. The others have been replaced by AA values as meter readings have come in and also now have positive EAC values in settlements moving forward. We recognise that our analysis is on a limited sample; however our findings are that 80% of the original negative EACs have now been resolved and should not be included in the compensation.

We are also concerned that DNOs have different views on how double counting should be monitored. Northern Powergrid are monitoring data up to the November 2010 report, stating that this is 'R3'; ENW are

monitoring data up to the November 2011 report. The result is that the CE methodology to avoid double counting is not taking account of a large number of mpans that have been fixed. The result is that Northern Powergrid are finding a reduction of 25% on the original negative EAC values (we believe it should be more like 80% based on our sample). ENW, through using later reports, are finding a reduction more in the region of 65%. It should be noted that the P222 report does not contain data for a particular run type. It is the EAC that is being used on the date that the report is run – as such, the same EAC may be covering SF, R1, R2, R3, RF and DF depending on the EAC start date (which is not available on the P222 report). The Northern Powergrid approach of only monitoring up to November 2010 is therefore flawed.

Establishing the right methodology

As can be seen from the YEDL and SPD graphs above, there is a wide range on reported losses. Both the CE and SP methodologies seek to establish a 'normal settlement period'. It is impossible to extrapolate the data available to calculate the 'correct' number since it is unclear even within which range the 'correct' number should be. What constitutes a 'normal' period?

The CE and the SP/Engage methodologies come up with significantly different results, and will have different impacts on consumer tariffs. It is clear that any methodology that is implemented will **not** provide the 'right' answer in terms of what the actual losses percentage should be since both methodologies seek to identify a 'normal settlement period' which does not exist.

The CE methodology has an additional flaw in that it provides bottom up adjustments (all in one direction) onto an already applied top down adjustment. This leads to 'double correction'. This should not be part of any methodology since the DNO is benefiting twice.

In summary, we do not believe that either methodology is suitable and **would strongly urge Ofgem not to implement.**

However, if we were to suggest a preference over the methodologies as they stand, we believe it should be a top down approach only i.e. the SP approach

DPCR5 Losses Incentive Scheme

We would like to discuss with Ofgem the forthcoming impacts on the Losses Incentive due to Feed In Tariffs (FIT). In the event that consumers are using less demand than they are generating, generation will spill into the distribution system. This will have the impact of reducing the calculated DNO losses since less import is required at the GSP group in order to meet demand i.e. the DNOs will receive windfall gain if the impact of Feed In Tariff Generation is is not taken into account? Is it Ofgem's intention to perform a similar adjustment under DPRC5 to correct for this (increasing) situation?

Timescales

We support Ofgem's approach to notify suppliers of the outcome of this by July 2011.

In summary:

- We have concerns over both methodologies since it is not possible to define a 'normal' period for any of the losses periods.

- We have additional concerns over the negative EAC double counting under the CE methodology and the fact that the DNOs concerned are using different approaches to ensure that double counting does not take place. The Northern Powergrid approach of only correcting up to data on November 2010 report results in less of an adjustment than the ENW approach of correcting on up to date data. While we believe that the ENW approach is better than the Northern Powergrid approach, the whole concept of making an additional adjustment to data where a top down correction has already been applied is flawed and should not form part of any methodology.

- For this reason, we believe a methodology if has to be chosen then one which only offers a top down approach is preferable i.e. the SP methodology. We do not, however, support any methodology being applied.

- We would like to draw Ofgem's attention to the fact that when DNOs did not question when losses were low and were receiving benefit.

- **If reinstatement of units for 2009/10 is considered accepted as a process, to be fair to consumers, losses over the whole DCPR4 should be is revisited using the SP methodology (i.e. to look at periods of under-statement of units as well as over-statement of units). If the whole process is not looked at, then the losses process should remain as originally defined – and formally agreed by the DNOs i.e. 2009/10 losses reinstatement should be unwound for DNOs who have already gone through this process. There should be no further restatement for 2009/10 losses by other DNOs.**

- We support Ofgem's proposed timescales of July12 notification on the approach.

- We would like to discuss with Ofgem the impact of Feed In Tariffs (FIT) on DPCR5 losses – which will result in a benefit to the DNOs.

Please feel free to contact me if you wish to discuss this response in more detail. This response is not confidential.

Many thanks,

By email so unsigned

Helen Inwood
Network Charging Manager

CHAPTER: Two

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

No. This consultation is only looking at one small part of why settlement data is subject to movement. It is important to recognise that there are many factors affecting the calculated losses. Suppliers have many incentives to correct data and to increase settlement performance. Over the course of DPCR4 losses period, suppliers will have been carrying out many processes that will affect the outturn losses calculation. The extent of this will have increased during the period. While we accept GVC and dummy meter exchanges are processes that do affect movements in the settled volumes, there are many other factors that will also impact it. These include: increased number of actual meter readings going into settlements, correction of erroneous data (including correction of meter technical details and other standing data, energisation status correction, D0095 resolution, large erroneous EAC/AAs etc). All will result in movements in 'metered consumption data' – some will cause increases, some will cause decreases. GVC and negative EACs should not be looked at in isolation.

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

The approach taken is one-sided since it is only taking into account factors that are not in the DNOs favour. There are many other factors which cause settlement data volatility - increased number of actual meter readings going into settlements, correction of erroneous data (including correction of meter technical details and other standing data, energisation status correction, D0095 resolution, large erroneous EAC/AAs etc. Some factors will cause consumption data to increase, some will cause consumption data to decrease. All should be looked at.

Importantly, Ofgem should also be looking at years when the calculated losses are lower than expected (e.g. YEDL 2005-7) to establish root cause. This should be taken into account if higher than expected losses are being investigated.

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?

No. For the reasons given above, we believe that the approach, if implemented, should be taking account of years where the data is lower than expected, as well as looking at years where it was higher. Otherwise DNOs are receiving windfall gains which will ultimately be paid for by consumers. If it is not intended to look at other years where the losses were lower than expected, we believe that it is inappropriate to apply adjustments to years where the losses are higher than expected.

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?

As above – we do not believe there is a 'normal' period. There are periods of low losses as well as high losses. These methodologies are only looking at the high losses – and therefore we believe a degree of cherry picking is taking place.

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?

We do not like either option but believe Option 2 preferable to Option 1.

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

No. We would like to cover the 2 methodologies in detail:

CE Methodology

There are flaws in this methodology:

It discards RF and DF data. Given that most of the meter readings, and hence AAs, will be obtained between R3 and RF, it does not seem appropriate to ignore this data. Having established a 'normalised' period, the methodology then provides 2 additional adjustments: negative EACs and one off data adjustments. This is providing benefit twice since the data is 'normalised' under the top down process and then compensated for again to take account of individual issues.

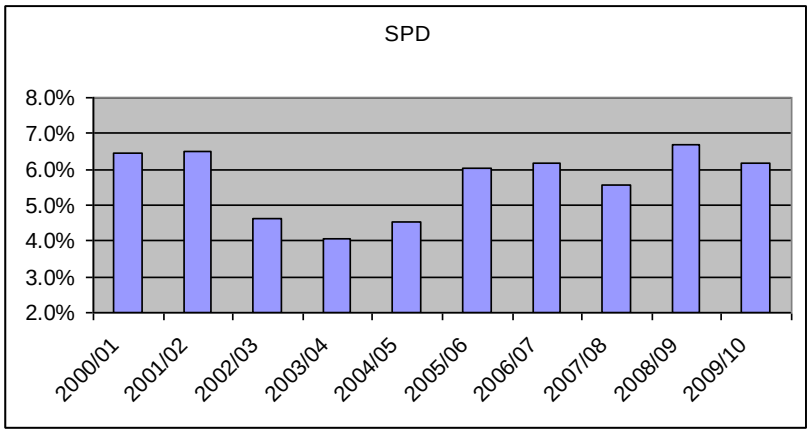
Negative EACs: The P222 report provides DNOs with the EAC that is settling on or around the date that it was run. However, it does not show the effective from date of the EAC. As more meter readings come in, the negative EAC is replaced by AAs and positive EACs. Our analysis has shown that 80% of the negative EACs on a random sample (50) of NEDL mpans which were originally in the reinstatement no longer have a negative EAC going through settlements. We have been unable to check the methodology to check that double counting does not take place, despite having requested the data on a number of occasions. In addition, DNOs are interpreting the methodology differently – ENW are using a much more up to date P222 report than CE. (see our attached letter above for further details on this). We do not support any adjustments for negative EACs. However, if a decision is made that it will be used, we believe ENW are removing duplicates in a much more appropriate way than Northern Powergrid.

Thurcroft: This correction should now have run through settlements. Again, we would like reassurance that the methodology put in place to ensure double counting does not take place is sufficient – is this using R3 or RF/DF data.

SP / Engage Methodology

We have large concerns with this methodology since it assumes a 'normal' period between 2005 and mid-2008. What is a 'normal period'?

Looking at historical losses data for SPD, it is impossible to determine a 'normal' period. The average for the DPCR4 period is 6.1%. 2007/8 is 5.6% (-0.5% below average), 2008/9 is 6.7% (0.6% above average). 2009/10 is almost identical to 2008/9 at 6.2%. Again, it is inconclusive to say which number is abnormal.



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?

No. The settlements calculations are much more complex – to get down to this detail, a methodology would need to take account of profiling, GSP correction factor etc.

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

These methodologies do not deal well with any settlements data correction – for the reasons given previously.

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?

For the reasons given above we do not believe it is possible to establish a 'normal' period. 'Abnormal' on these occasions are being assumed to be where losses are high. However, as we have shown above, 'abnormal' could be where losses were lower than expected.

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?

We do not believe either methodology is fit for purpose. Losses over the whole DCPR4 should be is revisited (i.e. to look at periods of under-statement of units as well as over-statement of units). The DNOs did not query when losses were low – if a methodology is to be applied, losses should be reviewed when they were low.

If the whole process is not looked at, then the losses process should remain as originally defined – and formally agreed by the DNOs i.e. **2009/10 losses reinstatement should**

be unwound for DNOs who have already gone through the interim process. There should be no further restatement for 2009/10 losses by other DNOs.

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

Although not being happy with Option 2 for the reasons given above, we believe it is better than option 1.

Option 1 methodology is not fit for purpose – and it is double counting benefit since a bottom up correction is being applied on an already corrected top down approach. We are concerned that the additional adjustments (metering errors / negative EACs) are not being adequately monitored.

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?

Settlement changes are always taking place. Every new meter reading / change in meter technical details / standing data is a settlements change and will impact the losses as measured by the calculation. npower are now doing less GVC than in previous years due to the closure of major data cleansing projects. However, there may be a need to do more GVC as Smart metering is implemented.

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?

No. We believe that settlements units should be left unadjusted when calculating the LRRM. Ofgem have identified that corrections due to GVC are generally for previous periods within DPCR4. This can clearly be seen in some of the data we have presented above where there is a period of lower losses in DPCR4 followed by a period of higher losses. As previously stated, if time periods where losses were lower is not looked at, we believe that the LRRM process should remain as originally defined – and formally agreed by the DNOs i.e. **2009/10 losses reinstatement should be unwound for DNOs who have already gone through the interim process. There should be no further restatement for 2009/10 losses by other DNOs.**

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?

No – as above.

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

The process should remain as originally defined – and formally agreed to by the DNO

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?

Both positive and negative adjustments need to be looked at.