SP ENERGY NETWORKS

Regulation & Commercial

Your ref AH/LC

Our Ref

Date:
15th December 2011

Contact / Extension
0141 614 1971

Lesley Ferrando
Local Grids and Governance: Distribution
Ofgem
9 Millbank
London
SW1P 3GE

Dear Lesley,

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

SP Energy Networks (SPEN) welcomes the opportunity to respond to this consultation. This response is submitted on behalf of SP Manweb plc (SPM) and SP Distribution Ltd (SPD) and comprises this letter by way of an executive summary of our views and the attached detailed response to specific questions and issues raised in the consultation. We do not consider this letter nor the detailed response to be confidential.

1. **We believe that the SP/ Engage methodology provides the optimal means to rectify SPM and SPD's reported losses.**

Our methodology quantifies abnormal settlements movements in a manner that is founded on a robust rationale. The methodology includes statistical analysis of non half hourly settlements data to isolate abnormal run type variations by comparing standard industry data reported during the DPCR4 period with natural cyclical variations during normal periods. The method is straightforward to apply and is auditable given its use of readily available industry data which we have verified with Elexon. Furthermore in its normalisation of the SF position the approach automatically allows for *all* underlying factors including consumer behaviour, i.e. recessionary impact, weather effects and most importantly Supplier behaviour changes in a non-discriminatory and therefore balanced way. For the avoidance of doubt, the SP/ Engage methodology cites the existence of negative EACs as being a *symptom* of abnormal patterns of behaviour but does not rely on these (negative EACs only) or subsequent monitoring of these as a key components of the *remedial calculation.*

In our published methodology we set out clear application guidance and our advisors Engage Consulting have set out how it can be applied by DNOs who use alternative reporting approaches to our own.

2. **We were surprised at Ofgem's current preference for the CE methodology. It is not clear to us that even Ofgem's own analysis of strengths and weaknesses which we believe to be flawed leads logically to this, albeit interim, view**

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Ofgem list four strengths and five weaknesses of the **CE methodology**, and six strengths and two weaknesses of the **SP/ Engage methodology**.

We are not convinced of Ofgem's perceived strength that the **CE methodology** can be easily replicated by other DNOs. Its use of negative EACs in the remedial calculation has presented difficulties for SPEN at least as we do not have a complete history of EAC data. The 'P222' report which holds information on EACs is not available retrospectively and we understand from Suppliers that this report is not fit for purpose in the context of corrections to reported losses. In completing Appendix 2 to the consultation we have had to make judgments in how to incorporate negative EACs to calculate the correction on a CE basis. A further strength quoted by Ofgem is that negative EACs are dealt with symptomatically when they arise. We have heard from Suppliers on several occasions that CE's use of negative EACs is problematic and as Ofgem highlight may actually be considered a weakness, one that the our methodology does not share.

Ofgem's first perceived weakness of the **SP/ Engage methodology** centres on subjectivity around the choice of normal period. Firstly we accept that any 'top down' methodology could be considered less than perfect. However our normal period is not *chosen*, rather it is identified by statistical comparison to normal settlement data cycles. We would stress that our findings were that a 'bottom-up' approach was not possible, which we discuss later. Elexon say that while they don't hold sufficient data to support a 'bottom-up' approach, DNO's receive sufficient data at aggregate level to support a 'top-down' analysis.[1]

Ofgem consider that the SP/ Engage methodology exhibits one other weakness, namely that it fails to take into account certain factors such as severe weather that could have a compensatory impact. This is simply not a valid criticism. The means by which we normalize SF takes into account *all* factors which are observably different from the normal period and therefore isolates abnormal variations in a balanced, non-selective way, i.e. we remove positive as well as negative abnormalities.

In summary we remain of the view that the SP/ Engage methodology has several key advantages and that these make it preferable in considering SPEN's and potentially other future DNO submissions. Whilst we do not seek to dispute that CE's methodology *could* be made to work for other DNO's it would present significant challenges to SPEN in its application due to unavailability of data.

3. We consider our submitted correction proposal to be fair to customers

One of ours and Ofgem's key considerations is fairness to customers. We believe we achieve this in our submission. Even if Ofgem approve our submitted correction, SPEN receives no reward and is in fact left with a very material penalty in the region of £50M across its two licensees despite the fact we have no evidence to suggest that actual underlying losses in our network have deteriorated.

4. In Developing and explaining the SP/ Engage Methodology we have very actively engaged with stakeholders to provide complete transparency

[1] Market Data Available from Elexon, DCMF workshop on GVC/Losses, 29th June 2011

In addition to meeting and corresponding with Ofgem on several occasions, we and our advisors Engage Consulting, have actively engaged with Suppliers, other DNO's and Elexon on this issue. We have carried this out on a bi-lateral basis and via attendance and presentations to the DCMF Gross Volume Correction/ Losses workshop, DCP30 Supplier calls and the recent Stakeholder Workshop. We are extremely grateful for all input.

These meetings have variously shaped our submitted correction methodology, allowed us to explain the methodology, raised awareness of the losses mechanism and kept Suppliers informed of the likely profile of forecast prices changes.

We would highlight one important part of that process, namely our Supplier Questionnaire which we issued in February this year. We wrote to all DCUSA Supplier Contract Managers seeking to understand better recent observed trends in settlement data. We asked for information on the use of GVC and other settlement adjustments and provided a template for the input of monthly GWhs adjusted during the DPCR4 period. The responses were very limited for reasons that we now understand, but importantly our attempt to gather data did lead us to conclude that a 'bottom-up' approach was not feasible.

In conclusion

In this letter we have presented some of the key issues that we wish to raise as part of the consultation. We explore these further and respond to other items raised within the consultation in our attached detailed response.

We recognise that considerable progress has been made in the past year on this difficult issue. We hope that Ofgem will see fit to approve our application for a correction to our data using the SP/ Engage Methodology. We remain fully committed to working with Ofgem and stakeholders on this and with related issues as we move into the target setting process for DPCR5.

Please do not hesitate to contact me if you require further clarity.

Yours Sincerely,

Allan Hendry
Regulatory Economics Manager
SP Energy Networks