

The background features a large, stylized white arrow pointing to the right, set against a blurred image of a modern building with a glass facade and a large, glowing, multi-layered circular structure resembling a turbine or a stylized sun. The overall color palette is light and airy, with blues, whites, and oranges.

RIIO-ED1 Losses Incentive Mechanism

LWG 28 May 2012

Agenda

- **Introductions and Minutes of last meeting**
- **Reminder of what any losses mechanism should aim to achieve**
- **Presentation of strawman papers of different approaches (20 minutes each)**
 - **Presentation of key features**
 - **Q & A**
 - **Assessment**
- **Summary of key aspects of the different options**
- **Determination of key approach/es to develop further and way forward**
- **DPCR4/DPCR5 losses issues**

Reminder: What are we trying to address through any losses mechanism?

- To encourage DNOs to reduce distribution network losses
 - Equipment decisions (investment) (in DNOs control)
 - Network operation (partially in DNOs control; partially other parties) incl theft
- Encourage other stakeholders to undertake actions to reduce losses (e.g. theft, pricing signals, DSO contracts)
- Improve on data accuracy
 - Settlements data correction
 - Standing data

Some key questions to bear in mind

- Should we be dropping or combining any of the approaches?
- How will the smart metering roll-out impact on any of the approaches?
 - Is it factored in to the approach?
 - Should it be factored into the approach for ED1?
- Does the approach allow for outputs to be measurable?
 - Would the data necessary to implement this approach be readily available?
 - At what cost?
- Does the approach encourage innovation?

**Some questions which could be
considered for each of the
approaches**

(to prompt discussion)

Duties based approach (licence condition)

- Overarching duty to ensure network losses are ‘as low as reasonably practical’.
- Who would determine what is reasonably practical? Would this be a standard or vary per network?
- What checks and balances would be in place to ensure an acceptable cost / benefit analysis was done for investment decisions?
- What value would be placed on a saved unit? On what basis?
- Selected audits:
 - How regular? By whom? At what cost? How would proportionate cost be evaluated?
- Would there be any penalties for non-compliance? In the Licence?

RIIO-T1

- Would there be sufficient incentive to reduce losses?
- How would investment decisions be audited / assessed?
- How would efficient equipment be measured (specs vs actual)?

Innovation Stimulus Type Approach

- Would all of the components be necessary?
- What valuation method would be best?
- Do the complexities surrounding the funding component negate any benefits to be obtained?
- Is it possible to simply utilise existing vehicles (Innovation Competition / LCNF)?

Assessed Outputs

Proposal has 2 parts – retention of DPCR5 mechanism with some changes (reduced incentive, increased cap collar, no close-out); and an assessed outputs similar to the DG incentive

- Who would audit the engineering model?
- Would it be a single model (all DNOs) or individual?
- How often would it need to be audited?
- How would the potential 'double counting' of benefits be addressed in the incentive rates?
- How would the sixteen year annuity align with an 8 year price control?
- The process would require an ex-post true-up and applying the IRR caps / collars. When (time lag?) / How?
- Is it correct to have an incentive rate similar to that of the current mechanism when only a portion of losses will be covered?

Post Investment appraisal

- What would be an “appropriate period” (2.2) for the assessment to take place?
- Will actual network and meter data be available? What additional equipment would be required to do the monitoring (get actual data)? At what cost? Would this have to be built into the initial investment proposal? Who would determine if the cost was reasonable / proportionate?
- Who would do the post investment appraisal – DNO / Ofgem / Auditor / other party? At what cost? How recovered?
- Would this be an annual reporting process?
- What would be an “acceptable variance” from the initial approval? Would this be fixed or depend on the type of investment?
- If appraisal does NOT align with initial investment:
- What would provide an “acceptable” justification? Would we have to set criteria up front?
- Who decides whether a justification is acceptable or not?
- Would this be a reporting requirement or licence condition?
- How would non-performance be managed?

Post Investment appraisal

For the proposed process review (2.4)

- What would constitute “sufficient” data – how many years’ worth?
- When would the process review happen – mid-term?
- What would constitute acceptable / excessive variance?
- If data suggests there is significant variance, how would we ‘switch on’ a claw back / penalty mechanism? Licence condition?
- If data suggests variance is low, how would we switch off the post assessment appraisal? Would the expenditure to date be justifiable?

For the proportionate approach (2.5):

- Who would determine the correct threshold of materiality?
- On what basis?
- Can we justify any mid term change/update to pre-investment approvals?
- Would this be retrospective or just changed going forward? (i.e adjustment mechanism)

Losses Index Mechanism

- How would a proportionate level be agreed? By whom?
- How would before and after modelling across DNOs be agreed? By whom?
- Is there sufficient data readily available to do so?
- Would this approach increase or decrease the dependence on data?
- Incentive on modelled changes in GWh to include energy cost and shadow price of carbon
 - Why both? Is this justifiable?
- Would the administrative burden on DNOs be proportionate to the benefits achieved?
- How would targets be set based on the variance?
- Would the targets be specific to each DNO or common across all?
- Would the annual reporting feed into a revenue driver?
- Would this be a standard or special licence condition?

Losses Index Mechanism

- How could an option to re-baseline losses improvements be effected?
- How often / when (e.g. mid-term or annual or on condition)?
- How could the suggested reconciliation process be effected? How regularly?
- What are the pros and cons of each of the possible approaches to rewards / penalties?
- How should the 'incentive rate' be determined?
- How could the interaction with real price effects and/or changes in energy flows / low carbon developments be taken account of?
- How would data cleansing activities impact the index?
- What type of data assurance measures would be envisaged?

Metering data and theft

- How would data corrections be measured?
- Do the mechanisms to do this currently exist?
- Who would establish the industry average correction rate?
- Does this require a mid-term review?
- How would adjustments (corrections) be effected and monitored? By whom? Would these be capped (collared)?
- Limiting long standing errors to 14 months would require estimations – by whom?
- On what basis should any incentive be set?
- How would we manage the interaction of incentives on different parties (DNO vs Supplier)?
- Would this approach cause any parties to ignore corrections in DPCR5 / store up corrections?
- Does this approach contradict current contractual conditions?

Theft

- Who would create a National RP body?
- Who would monitor/ govern a National RP body?
- Who would be responsible for reporting – DNO or National Body?
- How would it impact current contractual arrangements?
- If initial start-up costs were recovered from DNOs, how would this be allocated / governed?
- How would costs be capped (start-up and ongoing)?

Comparison table

(after interactive discussion session)

Key considerations	Duties Based	RIIO-T1	Innovation stimulus type approach	Assessed outputs (Pre investment)	Post investment appraisal	Losses Index Mechanism	Metering data and theft	Theft only
Proportionality	3	3	2	2	2	2	3	2
Transparency	1	2	3	3	3	3	2	2
Consistency	2	2	3	3	3	2	2	3
credibility	1	2	3	3	3	2	1	3
Clarity & Controllability	2	2	3	3	3	3	1	3
Adaptability & Commitment	3	2	3	2	3	3	2	2
Data requirements / availability	2	2	2	2	2	2	1	1
Associated costs / complexity	3	3	1	2	1	1	1	1
Incentive / penalty balanced	1	2	2	2	1	2	2	2
Reopener / review	3	2	2	2	3	2	2	1
Totals	21	22	24	24	24	22	17	20

2 Basic approaches

1) Incentive Based

2) Licence Obligation

- Which of the approaches to take forward
 - Which to combine
- Which (if any) to drop
- Who / What / When ?

The background of the slide is a composite image. On the left, there are rows of solar panels under a bright sun. On the right, a hand is shown holding a white document. In the bottom left corner, a blue gas burner is visible. The overall theme is energy and customer service.

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