Minutes

# RIIO-ED1 Losses Working Group Meeting #3

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| approaches to address Distribution Network Losses in the RIIO-ED1 Price Control Review, as well as some specific DPCR5 losses mechanism issues | From<br>Date and time of Meeting<br>Location | Lesley Ferrando<br>22 June 2012<br>10:00 – 13:00<br>Ofgem, 9 Millbank<br>London<br>SW1P 3GE | 18 July 2012 |

## 1. Present / Apologies

**For a full list of attendees and apologies please see Annex A.**

## 2. Discussion on Theft initiatives

2.1. A presentation was given on theft and the current initiatives to deal with theft in gas distribution. A copy will be made available on the Ofgem website. The presentation highlighted the substantial materiality associated with theft, estimated cost to customers around £400m per year.

2.2. Under gas arrangement, the key focus is on ensuring supplier actions, predominantly through a supplier licence condition. This is supported by a Theft Risk Assessment Service (TRAS), with an associated Gas Theft Code of Practice and an incentive scheme which is to be finalised by the end of 2012.

2.3. Questions were put to the group on where obligations to detect, investigate and prevent theft should lie in the context of electricity distribution; whether industry arrangements should address any incentives for suppliers and/or DNOs; and whether there is a role for the TRAS in managing electricity theft. The following points were raised:

- Any obligations must be linked to the legal power to disconnect.
- Although there are similarities between gas and electricity, they are not identical, with different legal rights and duties which would have to be considered in any framework.
- The group debated who currently has the obligation to do anything about electricity theft. Current legislation puts the obligation on the supplier where theft is from premises for which a supplier is registered. The DNO has the responsibility to pick up theft in conveyance (which includes theft from premises for which there is no registered supplier).
- There seems to be a commercial disincentive at the moment because of the cost of searching for theft, looking at how to manage it and potentially ending up with customers that are unable to pay.
- The group felt that there should be obligations on both suppliers and DNOs to control theft, particularly because each had access to different elements of data.
- While the first onus is on suppliers to manage theft, there are circumstances where the DNO will be best placed to identify large amounts of theft, such as where a customer keeps changing supplier (thus no clear history) or where the supply is not billed at all.
- DNOs have a role to play by putting in metering which could pick up the anomalies, but will need an incentive to do so. The advent of smart metering will need to take this into account.

- There was no agreed position on whether theft should be considered as part of the losses mechanism as it is currently, or not.

2.4. Conclusions reached are:

- There is a need for strong obligations / incentives to be applied to both suppliers and DNOs for electricity theft.
- Theft and the question of whether it should be part of the losses mechanism or a stand alone incentive should be addressed as part of the September RIO Strategy document.

## 3. Discussion on the 'Duties based' approach

3.1. John France led the discussion by setting out his paper.

3.2. Points of discussion were:

- In setting out duties regarding theft, the authority to act must be aligned with any obligations
- It would be helpful to link the duties based approach to a reputational incentive, though caution is needed about the accuracy of any data used to compare performance.
- The data provided by a DNO to demonstrate they had undertaken activity to reduce losses in line with its licence obligation should be published.
- Any incentive should encourage the correct behaviour, and not be too focussed on actual numbers (see data point above).
- Funding statement needs to be approved up front, setting out defined outputs.
- There are 2 possible ways to determine the value of the outputs – Ofgem could set the value at the beginning of the price control, or it could change annually. The group agreed that the value should use the price of carbon linked to the (wholesale) price of energy.
- Any penalty or reward could be calculated once the DNO had met their determined outputs. The outputs route leads to a reward (rather than penalty).
- The duty to maintain reliability would be covered in the licence.
- Among the considerations that would need to be in the duty would be the need for future innovation. It was agreed this issue should also be picked up in the innovation stimulus.
- Determining whether a DNO was in breach should be clearly set out.
- The group queried the scenario where a DNO was not reducing losses to reasonably practical levels at present, but setting action for the future in order to receive an incentive.
- It was felt that DNOs would also need to set out the difference between achieving 'reasonable' losses and aiming for a big step improvement.
- A fundamental question to be covered is how the investment appraisal would be done.
- If projects are not being done, the DNO would be penalised in terms of non-achievement of their licence obligations.
- It was felt that the duties based approach should be broadly consistent with the approach taken for RIIO-T1.
- If we're keeping the value of the mechanism high, there will be a high risk / impact.
- We need to take the roller element out, so there will be no rollover from any DPCR5 mechanism.

- Regarding audit requirements, if there is pre-implementation of the project / strategy, then we wouldn't need a big stick of onerous audit requirements.

## 4. Discussion on the 'innovation allowance' type incentive

4.1. Lesley Ferrando led the discussion (see presentation). Dora Guzeleva reminded the group of the basic structure of the innovation stimulus package and clarified that only the relevant part of it would apply to the losses mechanism. This included the network innovation allowance. It was further clarified that innovative projects to reduce losses would still be covered under the innovation stimulus package.

4.2. Points of discussion were:

- There are two types of projects to consider - where a DNO's losses reduction activities are 'business as usual' and those that are additional, extraordinary activities.
- DNOs would need to undertake equipment replacement on a cost/benefit basis.
- Network looping losses are only covered in technology / business practices at present, but should form part of the initiatives to identify and improve on losses performance. Smart grids will facilitate measurement of performance, and it will be more possible to identify these types of problems.
- The pre and post assessment of projects was discussed, relating to the period over which the assessment should occur. Some projects will be completed within a year, while others will span a number of years. Some will be specific projects while others will be more generic.
- In addition, some projects will not be completed by the end of the price control period, and should be taken into account.
- The group queried whether the innovation funding would be increased to account for losses reduction projects.
- The possibility of clawback of a portion of the allowance could disincentivise innovation.
- The group discussed an investment appraisal approach with annual revenue adjustment, similar to the current 'DG incentive' which would allow for additional investment / adjustment during the period.
- Any investment should be assessed against the lifetime of the asset, rather than the period of the price control.
- It was felt that some form of reputational incentive would be helpful for improving the effectiveness of the mechanism.
- The move to smart grids and more distributed generation connecting to the distribution networks could increase losses.
- It is felt necessary to consider how DNOs could be incentivised to encourage customers to change behaviour as part of helping to reduce losses.
- There is a need to consider flexibility in any arrangements given the changing landscape - EV charging for example.
- It was felt that DNOs should publish in their business plans and on an annual basis, what projects will be committed to. They should give an assessment of each project e.g. what will achieve in terms of losses improvement.

## 5. Consideration of both possible approaches

5.1. The meeting assessed the suitability of each of the approaches based on the questions set out in slide 2 of the presentation. It was agreed that the approaches could contain some similar components but should not yet be combined into one approach containing a licence condition and incentive.

5.2. While both seem to provide sufficient incentive to reduce losses, it was felt that the incentives based approach would provide more. It was less clear what the defined output of a duties based approach would be.

5.3. There will have to be clear guidance on what information needs to be included in the business plans and any annual reporting on the mechanism.

## 6. DPCR4/DPCR5 losses issues

6.1. Regarding the applications received by DNOs seeking to remove the effects of abnormal data cleansing from their 2009-10 losses positions, Ofgem highlighted that there is some difference in the approach each DNO has taken to deriving the data.

6.2. As had been discussed at a previous workshop, there is an outstanding question about the data required by DPCR5 Final Proposals for closing out the DPCR4 mechanism. At this stage, there was still work to do in understanding which DNOs had provided data that could be used for the purposes of close out, and which hadn't. Ofgem advised that it was working on this and would come to a decision shortly.

6.3. Ofgem went on to set out its intentions to consult on the question of whether to activate the DPCR5 losses incentive – following requests from across the industry not to. Alongside this broad question, it was highlighted that there would be a number of additional questions on issues affecting forecasts of DUoS charges and on the Distribution Licence.

6.4. Considering the impact of not activating the DPCR5 mechanism on DUoS charges, Ofgem asked the meeting for views on whether the value of PPL for 2013-14 should be set to zero in the next round of DCUSA forecasts in July. The views of the group were inconclusive. Ofgem highlighted that a question would be asked on this point in the consultation and that it was likely a response would be required in short order to be able to provide certainty on this issue ahead of the July forecasts.

6.5. Since the working group meeting, the consultation has been published and is now available on the Ofgem website.[1]

## 7. Agreed actions

7.1. The group agreed that specific initiatives to address theft should be followed up in September RIIO-ED1 strategy consultation.

7.2. The group agreed that both the proposed duties and innovation style approaches should be developed further for inclusion in the strategy consultation.

7.3. The following actions were required for the next meeting:

1) It was agreed that John France would revise the drafting to consider further how funding would be approved under the duties based approach, and how this would translate to an output.
2) It was agreed that Jonathan Purdy would take responsibility for steering the further development of the incentive based approach, with inputs from Mike Attree, Garth Blundell and Ofgem. The team would pick up on the points discussed, with specific points to be included / expanded on being:

[1] www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=6&refer=Networks/ElecDist/Policy/losses-incentive-mechanism

  a. Business plan strategy – approval of an allowance, how this would be assessed / valued
  b. Publishing of schedules of projects on an annual basis
     i. Projects committed to
     ii. Assessment of the project e.g. costs vs what they will achieve in terms of losses improvement
3) Both papers should also consider how the transition from the current mechanism would best be worked into the approach.

It was agreed that these should be ready for circulation by 11 July 2012.

## 8. Date of next meeting

The next meeting will take place on 18 July 2012 from 10:00 to 14:00 at Ofgem's offices, with full details to be confirmed later.

Annex A – RIIO-ED1 Losses Working Group #3

**Attendance: LWG 22 June 2012**

| | Name | Organisation | e-mail |
|---|---|---|---|
| 1 | George Moran | British Gas | George.Moran@britishgas.co.uk |
| 2 | Andrew Ryan | DECC | andrew.ryan@decc.gsi.gov.uk |
| 3 | Richard Cullen | Engage Consulting | richard.cullen@engage-consulting.co.uk |
| 4 | Mike Attree | ENW | Mike.Attree@enwl.co.uk |
| 5 | John France | Northern Powergrid | John.France@northernpowergrid.com |
| 6 | Keith Noble-Nesbit | Northern Powergrid | Keith.Noble-Nesbitt@northernpowergrid.com |
| 7 | Peter Collinson | Northern Powergrid | Peter.Collinson@northernpowergrid.com |
| 8 | Helen Inwood | Npower | helen.inwood@npower.com |
| 9 | Dora Guzeleva | Ofgem | Dora.Guzeleva@ofgem.gov.uk |
| 10 | Andy Cormie | Ofgem | Andy.Cormie@ofgem.gov.uk |
| 11 | Lesley Ferrando | Ofgem | Lesley.Ferrando@ofgem.gov.uk |
| 12 | Tim Aldridge | Ofgem | Tim.Aldridge@ofgem.gov.uk |
| 13 | Mark Elmer | Revenue Assurance | Mark.Elmer@rasplc.co.uk |
| 14 | Andy Tanner | Revenue Assurance | Andy.Tanner@rasplc.co.uk |
| 15 | Garth Blundell | SP | Garth.Blundell@ScottishPower.com |
| 16 | Stuart Andrew | SP | Stuart.Andrew@ScottishPower.com |
| 17 | Max Lalli | SSE | max.lalli@sse.com |
| 18 | Jonathan Purdy | UKPN | jonathan.purdy@ukpowernetworks.co.uk |
| 19 | Matthew Shore | UKPN | matthew.shore@ukpowernetworks.co.uk |
| 20 | Dave Wornell | WPD | dwornell@westernpower.co.uk |
| 21 | Simon Yeo | WPD | syeo@westernpower.co.uk |
| 22 | Matt Young | Revenue Assurance | Matt.Young@rasplc.co.uk |

**Apologies**

| | Name | Organisation | e-mail |
|---|---|---|---|
| 1 | Carl Bate | Consultant | carl.bate@hotmail.co.uk |
| 2 | Duncan Carter | Consumer Focus | Duncan.Carter@consumerfocus.org.uk |
| 3 | Julia Haughey | Edf Energy | julia.haughey@edfenergy.com |
| 4 | Trent Hardman | Elexon | Trent.Hardman@elexon.co.uk |
| 5 | Mike Harding | GTC (IDNO) | mike.harding@gtc-uk.co.uk |
| 6 | Tony McEntee | ENW | Tony.McEntee@enwl.co.uk |
| 7 | Harvey Jones | Northern Powergrid | Harvey.Jones@northernpowergrid.com |
| 8 | John France | Northern Powergrid | John.France@northernpowergrid.com |
| 9 | Allan Hendry | SP | Allan.Hendry@ScottishPower.com |
| 10 | Kevin Donaldson | Revenue Assurance | Kevin.Donaldson@rasplc.co.uk |
| 11 | Lorna Gibb | SP | Lorna.Gibb@ScottishPower.com |
| 12 | Paul Mitchell | SSE | paul.mitchell@sse.com |