ofgem

Minutes

RIIO-ED1 Losses Working Group Meeting #2 (Draft)

approaches to address Distribution Network Losses in the RIIO-ED1 Price Control Review, as well as some specific DPCR5 losses mechanism issues	From Date and time of Meeting Location	Lesley Ferrando 28 May 2012 12:00 – 17:00 Ofgem, 9 Millbank London SW1P 3GE	26 June 2012

1. Present / Apologies

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

2. Minutes

Minutes of the meeting held on 4 May 2012 were circulated. No objections have been received, and the minutes have therefore been taken as final.

3. Discussion on what a losses mechanism should aim to achieve

3.1. Ofgem highlighted the likely aims of any future losses mechanism:

- to encourage DNOs to reduce network losses through investment in equipment, and through network operation, including addressing theft issues;
- to encourage other stakeholders to undertake actions to reduce losses
- to improve on data accuracy allowing a more accurate measurement of losses

3.2. These were broadly agreed to, though there was some debate on whether data accuracy should be a key aim of any mechanism, and was subsequently agreed that it was a secondary aim.

4. General discussion and way forward

4.1. Ofgem presented a comparative table setting out an initial traffic light assessment of each of the proposals (strawman papers) put forward. Each of the proposals was then discussed in turn, and the comparative table adjusted based on the group's inputs (final slide contained in the presentation pack).

4.2. Some high level comments on each of the approaches were:

1. <u>Duties based approach</u>

- The duties based approach would take the form of a licence condition which would require DNOs to reduce losses on their networks, as opposed to an incentivised approach linked to a financial reward.
- There was a question whether a licence condition would drive DNOs to take any additional action to reduce losses over the bare minimum requirements of the licence.
  It was felt that the requirement to present well justified business plans would act as a reputational incentive. DNOs that demonstrated a particularly positive approach to improving losses could put be forward as a criteria for fast tracking.
- The approach would allow DNOs to take a common approach to losses which would facilitate comparison (consistent over time and across all DNOs).

- It would be important to be clear about what constituted a licence breach.
- Any licence condition would need to expand on what is perceived as 'efficient and economic' and consider assessment criteria – given that this is already a requirement of the Act. Equally, it would be important to ensure that any new requirement was proportionate and necessary given existing requirements.
- Any licence condition would need to allow for the fact that losses reductions from network improvements might be offset by other actions e.g. energy storage.
- Any licence condition would need to adequately address any potential conflicts such as 'economically efficient' vs 'the need to reduce carbon'.

2. RIIO-T1 approach

- The discussion covered similar issues to those raised for the duties-based approach. The group agreed that as these are very similar approaches; the two should be combined going forward.

3. Innovation type approach

- An innovation type of approach to losses would be based on a strategy similar to that of the Network Innovation stimulus, with an allowance for losses reduction activities. It was made clear that the purpose of this approach would not be to mirror completely that taken under the stimulus, but to take the elements which best fit the needs of losses.
- It was felt that this approach could favour a DNO who had previously not undertaken much work to reduce losses to date, compared to a DNO that had.
- DNOs queried whether the same percentage / level of allowance would be applied to each DNO.
- DNOs would have the best resources to model the investment decision process (rather than Ofgem). This should be taken into account in setting out the assessment process.
- The incentive should be based on the cost of carbon and the cost of energy saved (consistent with the current valuation).
- Suppliers queried how transparent the approval process would be.
- Extensive reporting requirements in terms of what had been achieved could be burdensome.
- As with the duties based approach, it was felt that a well developed or positive business plan submission could allow for fast tracking.

4. Assessed outputs approach

- The approach would be similar to the 'allowance' part of the 'innovation type' approach.
- The suggestion was to retain DPCR5 reporting for the purpose of getting the data right, but have
    - Tighter financial incentives
    - Broader GWh cap & collar
    - No roller
- It was also suggested that the incentive could follow an engineered approach, looking at pre-investment network characteristics, and consider asset life rather than be directly linked to the period of the price control.
- A key issue / risk is data suitable for any measurement – direct savings in losses will need to be demonstrated.
- Progress could be assessed annually on a RRP reporting basis.

- Questioned whether there should be any limits placed on the investment portfolio, or whether a DNO could justify a high level of investment in losses reduction equipment. The approach could apply an IRR Cap & Collar on the portfolio of projects.
- One of the assessment criteria could be selected replacement based on associated incremental cost.
- The approach would need to be combined with a post investment assessment and would also need to consider possible consequences if the investment hasn't actually achieved the benefit (if system modelled before and after). Concern was expressed that DNO and supplier could be undertaking conflicting actions which could undermine the demonstrable benefits of losses reduction.
- One DNO queried the criteria for determining what was in / out of scope of the approval.

5. Post-investment appraisal approach

- This would need to sit alongside the assessed outputs approach – the pre-investment network characteristics considered should be the same as the post-investment network characteristics. The approach would compare the characteristics to assess the benefits achieved.
- There was some concern regarding linking the post-investment appraisal to a claw back, at least until there was confidence in the model.
- There was debate as to whether investments should be considered on a case-by-case basis or total per annum / over the period.
- This incentive could also be used to incentivise accuracy in forecasting.
- There would need to be a close-down report done for each project which could be used in the assessment.

6. Losses Index approach

- The approach considered establishing a type of losses index (similar to the asset health index) against which projects could be assessed. This would be likely to be more prescriptive than an engineered model approach.
- There was some debate on how easy it would be to assess actions against this index.
- It was not clear how other (conflicting) actions and developments outside of the DNO's control (such as energy storage; low carbon initiatives) would affect assessment against the index.
- There were some concerns regarding consistency of the index across all DNOs.
- There were numerous associated complexities.
- The index would change over time depending on losses reduction actions undertaken.
- Aspects of this approach could be worked into the appraisal approach.

7. Metering data and theft approach / Theft only approach

- This discussion focussed on the treatment of units identified as theft and included in the total of losses.
- Suppliers queried why customers should have to pay additional incentives when theft detection is already a supplier responsibility.
- Theft has more far-reaching effects than just impacting on losses.
- There are wider industry initiatives to address theft issues.

- There is some scope to consider incentivising DNOs to undertake metering data and theft actions in those areas over which they have any control (at a reduced rate from that currently applied to losses).
- Addressing theft should be considered in developing any of the approaches further.

5. Agreed actions

5.1. The group agreed that there were two broad approaches to develop further for RIIO-ED1. The next meeting would consider whether the two approaches were stand alone, or could be used together to complement each other.

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

a) The duties based approach to be combined with the similar RIIO-T1 approach and expanded on. This approach should also consider how the metering data and theft approaches could be brought into the draft. Northern Powergrid to progress.

b) Relevant aspects of the pre-assessment, post assessment and losses index approaches to be worked into the innovation style approach and further developed, also incorporating points made regarding including some aspects of the metering data and theft approaches. ENW and Ofgem to progress.

6. DPCR4/DPCR5 losses issues

6.1. Ofgem highlighted the detail of a number of responses received to the recent cap and collar consultation, firstly on the subject of data cleansing and closing out the DPCR4 losses mechanism, and secondly on the subject of the DPCR5 losses mechanism.

6.2. On the data cleansing point, reference was made to paragraphs 4.19 and 4.20 of DPCR5 Final Proposals. The key point made, was that data used in the applications from DNOs to remove the effects of abnormal data cleansing activity from 2009-10 might not be consistent with the data required by Final Proposals for closing out the DPCR4 mechanism.

6.3. Ofgem considered the requirements of DPCR5 Final Proposals, which made clear that the requirements of data used in the DPCR4 close out process are that it has been fully reconciled and that all provision accounting unwound. It was not clear whether DNOs' applications were made on this basis. Ofgem committed to considering the matter in more detail – including whether the approach set out by Final Proposals constituted a requirement to use "settlement date" data or whether DNOs could continue to use their own reporting as a starting point for then applying all reconciliations to derive the close out data set – and offered bilateral meetings with all interested parties.

6.4. Ofgem made clear that the decision letter of 9 March 2012 was unaffected. But it also clarified that where it was found that data used in DNOs' applications was not consistent with DPCR5 Final Proposals, it was possible a further round of applications would be required.

6.5. On the DPCR5 losses mechanism point, Ofgem highlighted a number of responses which had requested that the DPCR5 mechanism be switched off. Ofgem clarified that it had made no decisions whatsoever on this matter, but was interested in the views of the working group. Of those participants who responded in the meeting, there was broad consensus that the mechanism should be turned off.

6.6. A number of options were then put forward by the group as to how this might be achieved. They included:

1. Not turning off at all
2. Turn off the DPCR5 mechanism after 3 years
3. Turn off full DPCR5 mechanism but close out DPCR4 as intended
4. Turn off full DPCR5 mechanism but do not run the DPCR4 close out calculation – do not allow removal of abnormal data cleansing from 2009-10
5. As per 4 – but allow removal of abnormal data cleansing 2009-10
6. Turn off full DPCR5 mechanism, do not run DPCR4 close out calculation and claw back all DPCR4 annual incentives
7. Replace with something different.

6.7. Ofgem agreed to take the matter away for further consideration.

7. Date of next meeting

The next meeting will take place on Friday 22nd June 2012 from 10:00 to 13:00 at Ofgem's London offices.

Annex A – RIIO-ED1 Losses Working Group #2

Attendance: LWG 28 May 2012

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Apologies

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