# Minutes

## RIIO-ED1 Losses Working Group Meeting #4

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| Approaches to address Distribution Network Losses in the RIIO-ED1 Price Control Review, as well as some specific DPCR4 and DPCR5 losses mechanism issues | From<br>Date and time of Meeting<br>Location | Lesley Ferrando<br>18 July 2012<br>10:00 – 14:00<br>Ofgem, 9 Millbank<br>London<br>SW1P 3GE | 10 August 2012 |

## 1. Present / Apologies

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

## 2. Minutes of previous meetings

2.1. There were no comments received on the minutes of 28 May 2012.

2.2. There were some minor changes suggested to the minutes of 22 June 2012, including a point on smart grids possibly increasing losses. These corrections have been made and the minutes finalised.

## 3. Discussion of the 'duties based' approach

3.1. John France led the discussion by setting out the key points of the revised paper which was circulated before the meeting. Points raised were:

- A duties based approach would be based on action to reduce losses to 'as low as reasonably practicable'.
- There would also be a requirement to publish a statement of how DNOs would comply with the duty; Ofgem would be able to undertake audit to ensure compliance.
- Addressing theft could be included in the duty but is not recommended
- While possible to include a reputational element, it would be difficult to determine a basis of measurement / comparison
- The extent to which a duty led to a material change in behaviour would depend on how a unit of losses was valued.
- An outdated ENA Engineering Standard (T8/6) was put forward as an existing engineering recommendation for the design of distribution networks to take account of losses. It was suggested that this might be updated by the ENA and the details applied through the duty. This would be likely to promote a more uniform approach by DNOs.

3.2. Key points of discussion were:

- A major factor in assessing the costs of complying with a duty for losses reduction is in determining the value put on losses. While a £/MWh of unit losses reduced should be based on the cost of carbon and the wholesale cost of energy, it's also necessary to set out the period over which the investment should be assessed. Past practice of linking the period to the price control period is not justifiable or suitable, and reasoning was put forward for setting the period to between 15 – 25 years.

- A duties based approach is unlikely to result in a dynamic change in investment (depending on the value of a unit of losses), but rather provide a stable environment ensuring some focus on reducing losses where practical.
- It was suggested that for some DNOs, this might be little different to what happens under the current mechanism. This is because the current value of losses (at £48/MWh calculated over a 5 year period) is not sufficient in all cases to proactively encourage DNOs to replace fully functioning kit just because a model with lower losses is available i.e. the assumption is that DNOs are currently only investing based on need when equipment needs replacement.
- It's important to differentiate between actions which are 'business as usual' and the value attached to improvements which would cause the DNO to pro-actively address losses reduction. We cannot assume nothing has been done about losses to date. It was suggested that the real value of losses reduction could be anywhere between the current rate and infinity, if the true environmental costs are included. The group agreed it would be unwise to set a value for losses reduction higher than other initiatives, eg carbon reduction incentives, as this would lead to perverse incentives and actions.
- DNOs would need certainty on this value and approach before putting together their business plans. The value will be integral to the CBA of any proposals put forward and would influence their approach in meeting their obligations.
- There was discussion about whether DNOs could use their role connecting distributed generation to help to reduce losses, for example asking a DG operator to connect somewhere else and then sharing the benefit. Any obligation should also consider that there are no windfall losses or gains accrued to a DNO simply as a result of smart grid or distributed generation decisions.

## 4. Discussion of the 'innovation style' approach

4.1. Jonathan Purdy set out the key points of the DNO Discussion Paper – A Distribution Losses Reduction Mechanism – which was circulated before the meeting.

4.2. Points of discussion were:

- The core behaviour must be about losses reduction activities, not about reducing total losses.
- Any losses reduction mechanism should be proportionate with other initiatives. An obligation as well as an allowance / incentive approach could be disproportionate.
- Further discussion on the importance of setting the value up front (as noted in the duties based approach) highlighted this would influence the business plan proposals, and will also affect the reporting and post investment review.
- There was discussion about whether the mechanism being developed lent itself more to an incentive or to an allowance. The incentive would allow DNOs to spend up to a pre-agreed value for losses reduction, and where they could deliver for less they would be able to keep the difference. The allowance would allow DNOs to spend a set amount on losses reduction with an ex-ante assessment of how much the actual cost of reducing losses came to.
- An incentive approach would require a mechanism to assess what actual reduction in losses was achieved. A concern was raised about the ability to incentivise the output.

## 5. Overarching discussion on both approaches

5.1. There were some concerns as to what would drive DNOs to undertake any losses reduction activities in the absence of an obligation to do so. However, there were also concerns that a simple duty would not result in losses reduction activity, particularly in the absence of explicit funding.

5.2. It was agreed that the two approaches were broadly similar, but that a losses reduction mechanism with an allowance might meet RIIO objectives better than a pure duties based approach.

Concerns remain on the actual measurement which could be applied to either approach, either in the investment strategy or in measuring an output. This leads to further problems with how to apply an incentive or penalty.

## 6. Restatement for close out of DPCR4

6.1. Tim Aldridge ran through Ofgem's interpretations of the two proposed options for restatement of 2009-10 for the purposes of closing out DPCR4. Option 1 required DNOs to identify abnormality based on settlement data, whereas Option 2 identified abnormality based on reporting data, before reconciling the corrected data set.

6.2. Explaining the application of the Ofgem statistical tests, it was highlighted that a key element of the SP correction methodology was consideration, and if necessary correction, of the SF position in 2009-10. This was to take account of the fact that abnormal data cleansing activity (and the recession) may have affected estimates. Consideration of the SF effect in the statistical tests therefore re-based the SF position that would have been seen had the data cleansing not taken place, enabling more accurate identification of abnormal activity. George Moran noted that the normal period used for any SF adjustment should at least contain credible losses.

6.3. The group discussed whether RF or DF data should be used for the close out calculation. DNOs had different expectations, based on their reading of Final Proposals, and different approaches were used in the first round of restatement applications. It was broadly agreed that DNOs should reconcile to the same settlement run as their DPCR4 reporting methodology did – Ofgem agreed to email LWG participants on this basis for views.

6.4. John France then expanded on the rationale for the second option for restatement for close out, which he suggested better reflected the basis on which the targets were set. George Moran expanded on the rationale for Option 1, which he felt was more in line with what Final Proposals (FPs) were seeking to achieve. It was agreed, however, that FPs did not cover the issue of data cleansing or data correction for that purpose – hence the need for the discussion.

6.5. A discussion on the merits of each of the two approaches followed, but the group was unable to reach a consensus. An alternative approach was suggested involving establishing abnormality based on reported data, before normalisation based on fully-reconciled data. The group were asked to consider whether any other approaches existed. Ofgem committed to e-mailing the group with the detail of the third option, and to setting out the way forward as a matter of urgency.

## 7. Consultation on whether to activate DPCR5 losses mechanism

7.1. Due to time constraints, this point was not discussed in detail.

7.2. Andy Cormie requested that all note the consultation deadlines, and provide responses as soon as possible. An early response on questions 9 and 12 was required.

## 8. Any other business

8.1. Dora Guzeleva noted that a point has been raised in various related discussions concerning the approach to be taken to energy consumed by a smart meter communications hub. The meeting agreed that as a result of the current proposals which move away from settlement data, this was not something which will fall within the scope of the losses mechanism and should be left for consideration through other initiatives.

## 9. Agreed actions

9.1. Ofgem will take the inputs and discussions on both approaches discussed into account in the drafting of the RIIO-ED1 Strategy Consultation. The consultation is likely to contain a number of questions which still need to be answered.

9.2. Ofgem to send out e-mail requesting clarity around whether to use the RF or DF reconciliation run in close out calculations and applications for removal of abnormal data cleansing.

9.3. Ofgem to send out e-mail setting out the suggested alternative approach and requesting views on any other approaches by the end of the week.

## 10. Date of next meeting

No further working group meetings have been scheduled.

Annex A – RIIO-ED1 Losses Working Group #4

**Attendance: LWG 18 July 2012**

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|---|---|---|---|
| 1 | George Moran | British Gas | George.Moran@britishgas.co.uk |
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**Apologies**

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