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Document D: DPCR5 Distribution Losses Reporting Requirement

Final decision

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Overview:

This decision document sets out Ofgem's decision to proceed with establishing a Distribution Losses Reporting Requirement within the current (Fifth) Distribution Price Control period (DPCR5).

It is part of a suite of documents being published to implement the Authority's decision of 16 November 2012 not to activate the Distribution Losses Incentive Mechanism in DPCR5 following a consultation published on 6 July 2012.

This document follows our consideration of responses to the July consultation, which sought views on the rationale for, and detail of, a new reporting requirement for Distribution Network Operators (DNOs). It sets out our decision in favour of establishing a new Distribution Losses Reporting Requirement. It also sets out the detail of the reporting requirement and how it will be implemented, and the DNOs' obligations.

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Context

1. This document is one of a suite of documents being published to implement our decision of 16 November 2012[1] not to activate the Distribution Losses Incentive Mechanism in DPCR5. That decision follows an open consultation published on 6 July 2012.[2] The decision affects various licence conditions and other documents, requiring further consultation and publication of decisions. The suite of relevant documents is set out in Chapter 4 along with a document map.

2. As well as asking for views on whether to activate the DPCR5 losses incentive, the 6 July 2012 consultation sought views on whether to replace it with a requirement for DNOs to report the actions they were taking to reduce losses. We have taken into account the responses received on that point and this document sets out our decision to implement a new Distribution Losses Reporting Requirement (DLRR) and explains the process for doing so.

3. The new DLRR will replace the DPCR5 losses incentive. The decision not to activate the DPCR5 losses incentive mechanism and to establish the DLRR therefore supersedes all references to the Distribution Losses Incentive Mechanism throughout all parts of DPCR5 Final Proposals. (A further document consulting on changes to the Distribution Losses Incentive Mechanism set out in DPCR5 Final Proposals is published alongside this consultation.)[3]

4. This document is to be read alongside the overarching decision document and also impacts on the previous Distribution Losses Reporting Regime that supported the DPCR5 losses incentive. The effect is that the previous reporting regime has been set aside and a new requirement (the DLRR) is established.

[1] http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/1A_Decision_Losses_DPCR5_161112.pdf
[2] www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=6&refer=Networks/ElecDist/Policy/losses-incentive-mechanism
[3] http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/2B_Con_Losses_Methodology_DPCR4_161112.pdf

Contents

1. Background to the decision not to activate the DPCR5 losses incentive

Problems with the DPCR4 and DPCR5 losses incentives

1.1. A financial incentive aimed at incentivising DNOs to reduce losses of electricity on their distribution networks has been a significant component of Ofgem's regulatory policy since the third distribution price control. The incentive has evolved at each price control review although the objective has remained to reduce the negative impact of losses on consumers (cost) and on the environment (carbon emissions). The incentive was developed on the expectation that losses are equal to the difference between the units entering and units exiting the distribution network. This measurement uses settlement data.

1.2. During the latter part of DPCR4 a number of problems with settlement data came to light, including the volatility of settlement data when used for measuring losses. The DPCR5 losses incentive mechanism included a two-year reporting lag to address this, but the levels of data volatility have changed to such an extent since its agreement that the mechanism cannot be effective.

1.3. Following our July consultation we have decided not to activate the DPCR5 mechanism. Since only two years of the DPCR5 period remain, and because there is no acceptable alternate method of measuring losses, we have decided not to replace the financial incentive, but to introduce a requirement for DNOs to report the actions they take to reduce losses. This document sets out the rationale for, and detail of, that reporting requirement.

Implementing a decision not to activate the DPCR5 losses incentive

1.4. The DPCR5 losses incentive was established in a number of policy, licence and reporting documents. These documents need to be amended in order to implement the decision not to activate the DPCR5 losses incentive. The full process is explained in Chapter 4 of the decision document ('Document A') and set out in further detail in Chapter 4 below.

2. Consideration of responses on a new reporting requirement

2.1. We said in the 6 July consultation that we did not believe it would be efficient to develop an alternative incentive mechanism to replace the DPCR5 losses incentive in advance of any RIIO-ED1 mechanism[4] which will come into effect in 2015. We also highlighted our continued concern about the impact of losses on consumers and the environment. We therefore sought views on our proposal to introduce a new reporting requirement for DNOs to inform us of the actual measures they are taking to reduce losses on their networks, as well as the detail of what DNOs should be required to report on, and the approach to publishing this information. We suggested that the information DNOs would be required to provide could be:

- the individual measures or programmes of measures they take to reduce losses in each of the remaining regulatory years of DPCR5
- the cost of each individual measure
- the expected effect of these measures on losses.

2.2. We also proposed requiring DNOs to report the actions they planned on taking ahead of the start of the 2013-14 Regulatory Year, and publishing those figures as a league table. They would then be required to update performance against these plans following the end of each year.

2.3. Eleven of the twelve responses to the consultation commented on the proposals, with eight in favour and three against. Two of the three responses against the proposals were received from the two respondents not in favour of turning off the DPCR5 losses incentive (one supplier and one DNO). They considered that a reporting requirement would be a poor replacement for a financial incentive. The other respondent against the proposal, Consumer Focus, was sceptical that the replacement would drive any behaviour, especially without more detail as to how it would work.

2.4. Of the eight respondents that agreed with our proposals, the majority felt the replacement reporting requirement was sensible so long as it was kept simple and proportionate. It was noted however that investment decisions in respect of losses reduction measures are likely to have already been made in respect of the remaining two years of the DPCR5 price control.

2.5. The proposed reporting requirement was thus unlikely to influence behaviour at this stage. This was one of the reasons why some respondents argued that a published league table would be inappropriate. Without credible data on which to measure performance, or detailed and explicit guidance on the process for reporting (which could be disproportionately burdensome), the basis for any league table could be subjective and the result not reflect actual performance.

[4] http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/riio-ed1/consultations/Documents1/RIIOED1SConOutputsIncentives.pdf (Pages 37 - 46)

2.6. Further comments recognised that the starting point would be different for each DNO. For example, the most cost effective actions available to one DNO might already have been effected by another. This could mean that loss reduction actions by one DNO could appear disproportionately costly when compared to another.

2.7. The majority of respondents agreed that the information that DNOs would be required to provide under the replacement reporting requirement would be appropriate. Building on the need to keep information requirements proportionate, the point was made that it would not be appropriate to report cost information in a way which could be detrimental to competition in the supply of low loss equipment. Some respondents however noted that a comparison between what had been purchased and the available alternatives would be helpful.[5]

2.8. Respondents also pointed out that network losses would be likely to change as a result of a number of factors. This could lead to a decrease as a result of actions to reduce losses, but an increase as a result of factors such as increased network demand and increased volumes of distributed generation connecting to the network. It was therefore suggested that an estimate of overall network losses would not be suitable or meaningful. One respondent noted that, when reporting actions, the life time of the asset should be taken into account. Some respondents raised the importance of reporting on what had actually happened to losses after the action was taken, that is, measuring the effectiveness of any action.

2.9. Most of the responses to the consultation highlighted the benefit of using information gathered through the reporting requirement to help shape the RIIO-ED1 losses mechanism.

[5] It is expected that this point is intended to refer to a comparison between standard and low loss equipment, rather than as a means of requiring the DNOs to demonstrate they have chosen the least cost low loss equipment available on the market at the time of the decision.

3. Decision and detail of the Distribution Losses Reporting Requirement ("DLRR")

3.1. Based on the responses to the 6 July consultation and the decision not to activate the DPCR5 losses incentive, we believe that a new requirement for DNOs to report the actions they take to reduce losses is appropriate. This document sets out our decision to establish the DLRR.

3.2. The reasons for not activating the DPCR5 losses incentive support our decision to replace the incentive with a reporting requirement. We do not intend for this to be an equivalent replacement for the incentive mechanism we are turning off, and acknowledge that it may be unlikely to influence behaviour at this stage in the price control. The DLRR aims to ensure a continued focus on loss reduction actions and document behaviour to allow this information to be used when we are making decisions on how to address the issue of losses going forward.

3.3. We believe the DLRR should be proportionate but also want to ensure that we have good information about the types of actions taken, their effectiveness and the associated costs. We share the concerns of respondents about the possible detrimental impact of overly detailed cost information on competition in supply of equipment. We believe, however, that the range of other costs associated with such equipment, including installation and maintenance costs, will vary sufficiently so as to mask the precise unit cost of equipment such as a low loss transformer.

3.4. We have therefore developed the DLRR to require DNOs to provide information on any action or programme of actions they take to reduce losses. We want to ensure that DNOs record actions which are both innovative and also consistent with the likely increase in demand, including for distributed generation connections. We will therefore require DNOs to report the physical actions (such as replacing an existing transformer with a low loss one) as well as the non-physical actions (eg encouraging a new distributed generator to connect in a location which would result in lower losses than if they had connected elsewhere; or instigating a programme to manage theft).

3.5. The information DNOs provide should be useful but not overly-burdensome. The only specific information we will require from DNOs will be with respect to cost and the estimated impact on losses. We will require DNOs to break that information down to a reasonable degree of specificity to give insight into what type of actions are being taken and at what points on the distribution network (eg EHV, HV, LV). This would mean reporting each individual action taken or breaking down programmes of work so that, for example, different classes of equipment or actions on different parts of the network are indicated separately. We will also require DNOs to clearly set out the projected losses reduction they are attributing to the investment decisions over the whole lifetime of the assets.

3.6. We agree with those respondents that highlighted the need to understand how the loss reduction action differed from a standard business approach. This means understanding what difference the action has made in isolation of other developments on the network, for example increased demand or increased distributed generation. We will therefore require DNOs to report the losses expected to be reduced by the equipment or action beyond that which would have been achieved through their standard business approach. One example could be where one transformer is replaced with another that provides for lower losses. The estimate will be the difference (in GWh) between the energy which would be lost through use of the first transformer and the energy lost through use of the second. Another example could be where the identification and eradication of an instance of theft would also result in a reduction in losses by the stolen amount.

3.7. Similarly, if a distributed generator is encouraged to connect to an alternate location, the estimate will reflect the difference in losses (in GWh) between connecting in one location compared with the other. It will not be an estimation of the net losses of the action to encourage relocation and the connection of the distributed generation itself, since it is recognised that in some cases overall losses may in fact increase.

3.8. Understanding how the action is different from the standard approach in terms of associated costs means understanding what the cost of a standard piece of equipment would have been. It is however recognised that identifying a standard cost for some actions to reduce non-technical losses is likely to be difficult.

3.9. We also want to understand what factors drive the decisions each DNO is taking in this regard, as well as receive any relevant information in respect of the cost benefit assessments undertaken. We will therefore require DNOs to explain the driver (rationale) for each action, alongside the specific cost and loss reduction information. We want to understand, for example, whether an asset being replaced has reached the end of its operational life or whether the replacement is undertaken specifically to reduce losses.

3.10. We would expect most, if not all, of the information above to feature in the cost benefit assessments that DNOs carry out in making their investment decisions. We do not consider that requiring this information in the DLRR will represent an unfair reporting burden, particularly compared to the amount of work which has been removed by not implementing the DPCR5 losses incentive mechanism and its reporting regime.

3.11. We accept that each network is different and consequently that the starting point for the DLRR will be different for each licensee. To avoid overly prescriptive or burdensome reporting requirements, and the risk of comparisons being made without taking due account of those differences, we will not publish results in a league table format. We will however publish the reported data received from each DNO.

3.12. We will therefore require DNOs to report on the actions they have taken, and the actions they still plan to take for the rest of the DPCR5 price control period, in the Regulatory years beginning 1 April 2013 and 1 April 2014. This reporting will be required by 31 July 2014 and 2015 respectively.

4. Implementing the DLRR

4.1. As provided for by the overarching decision document, the DLRR will be the main requirement on DNOs in respect of losses for the remainder of DPCR5. Both the DPCR5 losses incentive mechanism (set out in DPCR5 Final Proposals and the Special Conditions of the Distribution licence) and the original Distribution Losses Reporting Regime (set out in the Standard Conditions of the Distribution licence and the Regulatory Instructions and Guidance document (RIGs)), will be replaced by the DLRR.

4.2. The following diagram illustrates how the documents being published to implement the decision not to activate the DPCR5 losses incentive fit together. Their relationship is explained in Chapter 4 of the overarching decision document, Document A.

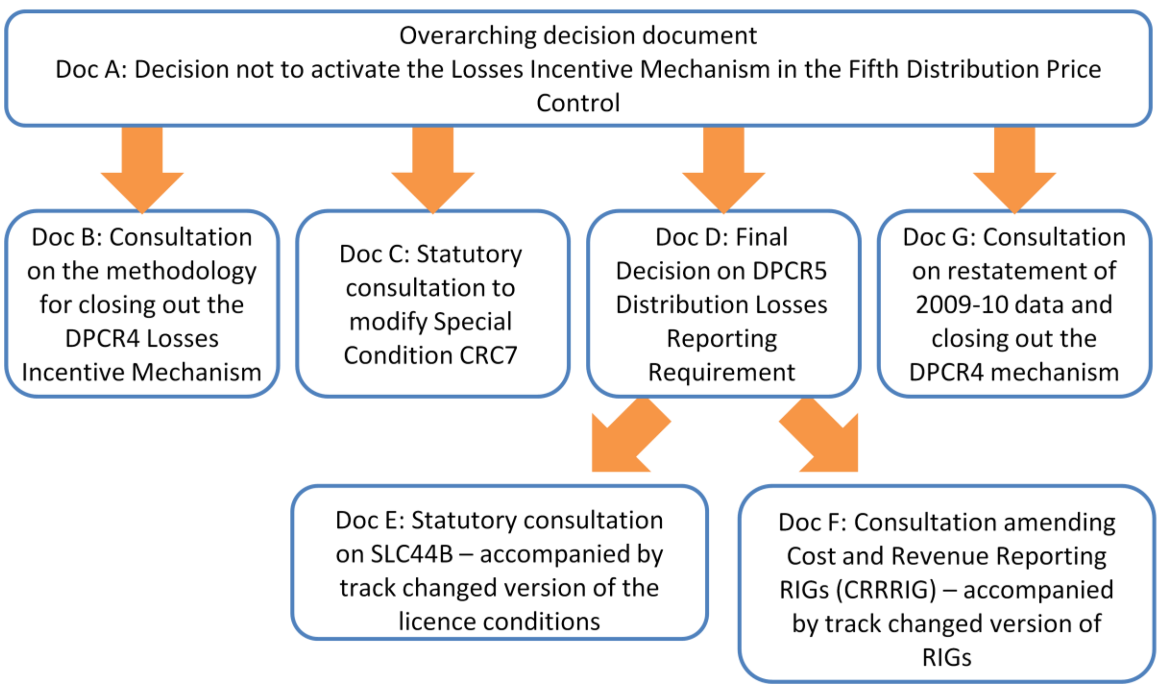

Figure 1: Document map showing relationship between the documents published to implement the decision not to activate the DPCR5 losses incentive

4.3. In terms of implementing the DLRR, the approach will be similar to that of the previous Distribution Losses Reporting Regime. SLC44B, which set out the licence requirements for the reporting regime, will be amended accordingly, as will the RIGs document which sets out the detailed reporting requirements. The relevant consultation documents are published alongside this document.

4.4. Modifications to SLC44B and a number of minor and consequential modifications to other Standard Conditions will be implemented through a statutory consultation that will run for 28 days from the date of the Notice (Document E) that is published at the same time as this document. The statutory consultation period will be followed by a decision which will take into account any responses received to the statutory consultation. Should the decision be to proceed with the modification to SLC44B then that decision will be published and will take effect 56 days after publication.

4.5. Document F is a consultation on the Amendments to the RIGs documents as a consequence of this decision. We are consulting on these amendments alongside the associated changes to SLC44B and therefore are consulting for the same period of 28 days.