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Decision on the methodology for closing out the DPCR4 losses incentive mechanism

Final decision

Reference: 01/13
Publication date: 3 January 2013

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Overview:

This document sets out the methodology for closing out the fourth distribution price control (DPCR4) losses incentive mechanism in light of our decision not to activate the distribution losses incentive mechanism in the fifth distribution price control (DPCR5).

The changes we have decided to make to relevant sections of DPCR5 Final Proposals (FPs) are set out in Appendix 1 and Appendix 2.

Associated documents

To give effect to our decision not to activate the losses incentive mechanism under DPCR5, we have made modifications to Special Condition CRC7 of the Electricity Distribution Licences so that it references this decision in calculating the close out value. These modifications have been issued alongside this decision:

Modification of Special Condition CRC7 of Electricity Distribution Licences

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/Modification%20direction%20to%20CRC7.pdf>

Modification of Standard Licence Conditions of the Electricity Distribution Licence

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/Modification%20direction%20to%20SLC44B.pdf>

Document G: Consultation on restatement of 2009-10 data and closing out the DPCR4 losses incentive mechanism (16 November 2012; Ref 150/12) closes on 28 January 2013.

http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/8G_Con_200910data_losses_DPCR4_161112.pdf

Further background on the rationale for our decision to not activate the distribution losses incentive mechanism for DPCR5 is available here:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=755&refer=Networks/ElecDist/Policy/losses-incentive-mechanism>

1. Introduction

1.1. Losses are an inevitable consequence of transferring electricity across the distribution network and they have a significant financial and environmental impact. There are things that Distribution Network Operators (DNOs) can do to manage losses on their system. To encourage DNOs to manage an efficient level of losses on their network, we introduced a losses incentive mechanism as part of our electricity distribution price control. Under this mechanism, DNOs calculate their losses by reference to the difference in electricity that flows in and out of their network using settlement data.

1.2. On 16 November 2012, we decided not to activate the losses incentive mechanism in the fifth distribution price control (DPCR5) because of our concerns about the volatility of settlement data. Whilst some of the problems with the losses incentive mechanism were known during the previous price control, DPCR4, the most significant concerns only crystallised in recent years.

1.3. We decided that we could not support an incentive mechanism in DPCR5 that could result in unwarranted rewards and penalties of significant value and could potentially expose customers to unjustified costs.¹

1.4. Because of the detrimental impact on regulatory certainty, we were not prepared to go as far as unwinding the DPCR4 losses incentive mechanism.

1.5. We published a consultation on 16 November 2012 setting out the proposed changes to the DPCR5 Final Proposals (FPs) which we consider necessary to implement our decision not to activate the losses incentive in DPCR5 and to close out the incentive under DPCR4.² We set out all of the proposed deletions and modifications to the DPCR5 FPs in our consultation document.


1.6. After carefully considering the five responses we received to our consultation, we have decided to make some changes to the DPCR5 FPs additional to those outlined in the consultation. The responses are published alongside this consultation.

1.7. All of the responses considered that the changes to the methodology are consistent with our decision not to activate the DPCR5 losses incentive mechanism. Three responses suggested further changes to the text that would make it more consistent with the decision. We have only made further changes that we consider necessary to help remove any unintended consequences of implementing the decision not to activate the DPCR5 losses incentive mechanism. The further changes we have made are presented in consolidated form in the appendices.

¹ Our decision is available for download from:

http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/1A_Decision_Losses_DPCR5_161112.pdf

² http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/2B_Con_Losses_Methodology_DPCR4_161112.pdf



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1.8. One of the responses requested that paragraphs 4.19 to 4.21 of Final Proposals: Financial Methodologies (Ref 148/09) should be amended to remove any perceived ambiguity. These paragraphs have been the subject of intensive industry scrutiny over the past nine months. In working with industry we have sought a pragmatic resolution to the implementation of these clauses, particularly in relation to restating data to address abnormal levels of supplier activity that were not anticipated at the time FPs were developed.

1.9. We consider that the substantive point made by this respondent (concerning how the text should be interpreted) would be better addressed in response to the consultation on closing out the DPCR4 losses mechanism.³ We are leaving these paragraphs unchanged in line with our approach of not making changes to text unaffected by the decision not to activate the DPCR5 losses incentive mechanism.

1.10. For ease of reference, we have reproduced the changes we have decided to make to the DPCR5 FPs as appendices to this document. The calculation of the close out of the DPCR4 losses incentive mechanism was covered in two separate sections of DPCR5 Final Proposals. Appendix 1 describes the updated close out provisions from the Incentives and Obligations section (Chapter 7 of the FPs) and the Financial Methodologies section (Chapter 4 of the FPs). Appendix 2 lists the remaining paragraphs in the FPs that were nullified or required amendment because of our decision not to activate the losses incentive mechanism for DPCR5.

1.11. We have noted in the appendices where text has been removed or amended. The paragraph numbering and formatting in the appendices replicates the relevant parts of FPs.

1.12. To avoid doubt, any text remaining in FPs that is contrary to our decision, or needs to be removed to implement our decision, will no longer be in effect, even if we have not directly indicated that it is to be deleted. Similarly, any text which has been removed whose removal is not necessary for implementation of our decision, will remain in effect.


1.13. In addition to the changes set out in this document, we have made changes to some of the conditions in Electricity Distribution Licences to give full effect to our decision not to activate the losses incentive mechanism in DPCR5 and to close out losses under DPCR4. This decision should therefore be read alongside those licence modification decisions.⁴

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<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=762&refer=Networks/ElecDist/Policy/losses-incentive-mechanism>

⁴ The licence modifications can be found at:

<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/Modification%20direction%20to%20CRC7.pdf> and <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/Modification%20direction%20to%20SLC44B.pdf>



Decision on the methodology for closing out the DPCR4 losses incentive mechanism

1.14. We are currently consulting on the restatement of losses data by some DNOs and the final values for the losses incentive (the 'PPL term') for each DNO.⁵ We anticipate directing the PPL terms in March 2013 and recovery of the PPL term will occur over the 2014-15 and 2015-16 regulatory years.⁶

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<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=762&refer=Networks/ElecDist/Policy/losses-incentive-mechanism>

⁶ <http://www.ofgem.gov.uk/Networks/ElecDist/Policy/losses-incentive-mechanism/Documents1/Question%20on%20the%20consultation%20on%20restatement%20of%202009-10%20data.pdf>

Appendix 1: DPCR4 close out provisions

Summary

This document provides instruction on the process for closing out the DPCR4 losses incentive mechanism. It replicates the relevant sections of DPCR5 Final Proposals but includes none of the links between the DPCR4 and DPCR5 incentive mechanisms. Where text has been removed or amended, it is noted accordingly. All terms and definitions will remain as set out in the DPCR5 Final Proposals. The sections in the remainder of DPCR5 Final Proposals that no longer apply are listed separately in Appendix 2.

[Original Document: Electricity Distribution Price Control Review Final Proposals – Incentives and Obligations - 145/09]

Chapter 7: Treatment of DPCR4 losses rolling retention mechanism

Purpose

7.1. The losses incentive in DPCR4 included a rolling retention mechanism to encourage loss reduction initiatives to be undertaken at any time in the price control period by guaranteeing rewards (or penalties) for a subsequent five year period.

7.2. This chapter describes how we intend to calculate, for each DNO, the total losses incentive amount arising from DPCR4 losses performance, and therefore the remaining amounts owed to/by the DNOs.

[Note: the text at paragraphs 7.3 – 7.9 is left unchanged since it replicates a decision made in the DPCR5 Final Proposals document for the way in which the LRRM would be developed. Some of the “adjustments and calculations required to bring this decision into effect”, as referred to in paragraph 7.9 are amended or deleted in later text. The reader should note that the DPCR5 losses incentive mechanism itself has not been activated.]

7.3. In Initial Proposals we recognised the uncertainty surrounding the remaining amounts under the DPCR4 losses incentive and invited proposals for a buy-out option that could be demonstrated to be equitable to consumers. We have decided not to apply a buy-out option and explain the reasoning behind this conclusion below.

Developments since Initial Proposals

Decision on the methodology for closing out the DPCR4 losses incentive mechanism

7.4. In Initial Proposals we proposed to expose the absolute losses performance to the losses rolling retention mechanism (LRRM) as set out in the DPCR4 Final Proposals⁷.

7.5. In DPCR4 the incentive mechanism was created so that the LRRM retains each year's incentive amount earned on the incremental change in outturn losses for five years. In discussions with the DNOs we have explored the algebra behind the LRRM and have explained that the LRRM equates to five times the final year losses performance against the target. We consider this property to be appropriate as the purpose of the incentive is to reward sustainable changes in losses, and therefore the final year should reflect the cumulative efforts over the entire price control period.

7.6. Some DNOs disagreed with our interpretation of the DPCR4 Final Proposals. They argued that the DPCR4 intent was that the 2009-10 value for losses would be calculated as the average of the losses reported in the first four years of DPCR4. The DNOs based their view on the example contained in Appendix 1 of the DPCR4 Final Proposals which used a calculated figure for the outturn losses in 2009-10 to derive the losses rolling retention amount.

7.7. Since Initial Proposals we have analysed the DPCR4 Final Proposals Appendix 1 in some detail. It is clear to us that the intention in the DPCR4 Final Proposals was to use the average of the losses target for the DPCR5 period as the calculated figure for the fifth year of the DPCR4 losses⁸. This means that the LRRM would be determined by five times the difference between the DPCR4 and DPCR5 targets. This was in order to make sure that there was no double counting of the benefits (losses) received by the DNO through the LRRM and under the targets set for DPCR5.

7.8. For example, if a DNO finishes the DPCR4 period with final year losses below the DPCR5 target, it would benefit from a starting position in DPCR5 that allows it to earn under the DPCR5 losses incentive without making further efforts to control losses. If the LRRM allowed the DNO to keep five years worth of its performance in the last year then this would involve a double benefit to the DNO. Similarly, if a DNO's losses increased towards the end of DPCR4 it may start the DPCR5 period with a penalty under the new incentive. If the roller carried forward the DNO's penalty in the final year of the DPCR4 incentive then the DNO would be hit twice: once by the LRRM and again by the need to make efforts to meet the new target below its starting losses position.

7.9. We consider that it is appropriate to apply the LRRM as intended in the DPCR4 Final Proposals, so that there is no double counting of the benefit/penalty that the DNO experiences through the LRRM and the benefit/penalty that might arise as a

⁷ Electricity Distribution Price Control Review, Final Proposals, 265/04; available for download from www.ofgem.gov.uk/Networks/ElecDist/PriceCtrls/DPCR4/Documents1/8944-26504.pdf

⁸ Paragraph A1.38 in the Final Proposals Appendix 1 states that the approach takes account of the interaction of benefits beyond 2010 and the level of targets beyond 2010. The intent to use the average DPCR5 targets is reflected in the table A1.2 where the row containing the calculated figure is labelled "average target for DPCR5" and is confirmed by algebra contained in the example spreadsheet that was issued by Ofgem to the Incentives Working Group on 11th November 2004.

result of the new losses target for DPCR5. As such, total gains or losses for each DNO will equal five times the final losses outturn. We will need to make a number of adjustments and calculations to bring this decision into effect. These are set out in more detail below.

Details of our proposal

Close out of DPCR4 losses incentive

7.10. In closing out the DPCR4 losses incentive we intend to apply the LRRM (as described above) and to take steps to ensure that there are no windfall gains or losses to the DNOs arising from:

- settlement data corrections and provision accounting, [text deleted]

Adjustments arising from settlement corrections and provision accounts

7.11. As we stated in Initial Proposals, adjustments to DPCR4 reported losses will be required in order to ensure that all DNOs receive the losses incentive based on their absolute losses performance over DPCR4 and ultimately, that rewards/penalties under the DPCR4 scheme are not influenced by the different reporting bases that companies used.

7.12. The settlement data from which losses are calculated is likely to be revised after the end of the DPCR4 period. We will therefore require the DNOs to report corrections to the DPCR4 losses that take place after the end of DPCR4, so that the final year reported losses can be revised accordingly.

7.13. A number of companies have used provision accounts in arriving at reported losses during the DPCR4 period. Where this is the case we will require the DNO to demonstrate to us that, as final settlement data becomes available, units in provision accounts have been allocated to their appropriate years, and the provision accounts closed out. DNOs will need to disclose what proportion of their reported losses is due to provision account adjustments and therefore what the actual losses in the final year were.

7.14. However, the final year losses reported by the DNOs will probably include corrections to the settlement data for prior years. In order to ensure the LRRM works correctly, the losses figure that we will adjust (according to paragraphs 7.12 and 7.13 above) will be the losses experienced in the final year, excluding any corrections to prior years and prior to any provision account adjustments.

Adjustment arising from the new methodology

7.15. [Text deleted]

7.16. [Text deleted]

7.17. [Text deleted]

Adjustment arising from the DPCR5 targets

7.18. [Text deleted]

Close out calculation

7.19. [Text deleted] we will only be able to calculate the LRRM in 2011-12 once final settlement data is available.

7.20. We will then calculate the 'close out' amount as the total retained losses incentive less the amount of losses incentive the DNO has already received (due to DPCR4 losses) during DPCR4. Depending on the materiality of these amounts we will consider the appropriate period over which to spread the recovery or payment, taking into account the impact on revenue stability and on DNO cash flows.

7.21. More detail on the calculation of the close out of the DPCR4 losses incentive is included in Chapter 4 of the Financial Methodologies document.

Buy-out option

7.22. In Initial Proposals we stated that our view at that time was that it was appropriate to adjust DPCR4 performance for final settlement data and to apply the rolling retention mechanism as considered in the DPCR4 Final Proposals. However, we recognised that this caused uncertainty for DNOs as the value of earnings under the DPCR4 losses incentive would only become known part way through the DPCR5 period, once the final settlement data for the DPCR4 period became available. We therefore considered two options:

- switch off the DPCR4 mechanism, or
- permit DNOs to buy themselves in or out of the DPCR4 mechanism (buy-out option).

7.23. We stated in Initial Proposals that we did not consider switching off the DPCR4 mechanism to be an appropriate response, since the LRRM was clearly identified in the DPCR4 Final Proposals, and DNOs will have invested in low loss equipment and loss reduction initiatives based on the expectation that loss incentive rewards would accrue over a five year period. By switching off the mechanism we would, in effect, penalise the DNOs who reduce their losses in the latter years of DPCR4, since they would receive less total reward.

7.24. However, we stated in Initial Proposals that we were prepared to consider proposals for a buy-out option if DNOs could develop an option that was fair to customers. Three DNOs submitted potential proposals, but only one incorporated a risk sharing mechanism between the DNOs and customers. We also had concerns that DNOs' views of their potential 2009-10 losses might lead to a selection bias in terms of which DNOs would choose to pursue a buy-out option and that this would increase the risk to customers.

7.25. Unfortunately our analysis indicated that in the context of the DPCR4 losses performance to date, the risk sharing proposal still favours the DNOs. We therefore

assessed whether it was possible to modify the proposal to provide a more balanced distribution of risk.

7.26. We concluded that even with modifications, any buy-out option will still leave the majority of risk on customers and will be overly complex in order to accommodate the different losses reporting methodologies in use in DPCR4. Any option would not address the selection bias unless the buy-out was imposed on all DNOs.

7.27. We therefore do not intend to offer a buy-out option to the DPCR4 LRRM. We consider that it is appropriate to retain the retention mechanism as this is part of the DPCR4 incentive design and ensures that DNO net earnings under the mechanism reflects performance throughout the five year period.

DPCR4 loss adjustment for Scottish Power (SP)

7.28. In July 2009 the Authority considered a representation by SP for an uplift in SP Distribution's DPCR4 allowed loss percentage (ALP) to correct an error in its original calculation pertaining to extra high voltage (EHV) sites. The Authority agreed that there should be a retrospective adjustment to the ALP and that this would entail applying an uplift of £13.2m to SP Distribution's base revenue in 2010-11⁹. The amount is based on the actual effect of the ALP change for regulatory years 2005-06 to 2008-09 and an estimate of the effect for 2009-10.

7.29. In cash terms, SP have advised us that they have already recovered some of the uplift amount through charges in anticipation of the award implementation. This means that they will report an 'over-recovery' position in respect of actual versus allowed revenue for 2009-10 which will be offset against the revenue uplift allowed in 2010-11.

7.30. As soon as possible after submission of SP Distribution's revenue return for 2009-10 we will calculate a 'true-up' adjustment for SP Distribution which will:

- Add or deduct an appropriate sum to reflect reported losses performance in 2009-10, and
- compensate for any penalty rate of interest applied to SP Distribution's correction factor (brought forward over-recovery) for 2010-11.

7.31. We will apply the DPCR4 LRRM for SP Distribution in the same way as proposed above for the remaining DNOs.

[Original Document: Electricity Distribution Price Control Review Final Proposals - Financial Methodologies – 148/09]

Chapter 4: Losses incentive

⁹ Available on Ofgem's website at: www.ofgem.gov.uk/Networks/ElecDist/PriceCntrls/DPCR4/Documents1/Decision%20Letter_SP%20ALPs_31%20Jul%2009.pdf

4.1. [Text deleted]

DPCR5 target setting

4.2. [Text deleted]

4.3. [Text deleted]

4.4. [Text deleted]

4.5. [Text deleted]

4.6. [Text deleted]

4.7. [Text deleted]

4.8. [Text deleted]

DPCR5 Annual Smoothing

4.9. [Text deleted]

Treatment of DPCR4 LRRM

4.10. In this chapter we provide further explanation of the treatment of the DPCR4 LRRM¹⁰.

DPCR4 Final Proposals

4.11. As stated in Chapter 7, we propose to give effect to the DPCR4 Final Proposals when calculating the total losses incentive over DPCR4 [text deleted].

4.12. In DPCR4 the incentive mechanism was created so that the LRRM retains each year's incentive amount earned on the incremental change in outturn losses for five years.

4.13. As demonstrated in Figure 4.1 this equates to five times the final outturn losses. We consider this property to be appropriate as the purpose of the incentive is to reward sustainable changes in losses, and therefore the final year should reflect the cumulative efforts over the entire price control period. As shown in Figure 4.1 the net change is $5 \times E$, where E is the target losses minus the reported losses in the final year.

¹⁰ Chapter 7 of the Incentive and Obligations document

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GWh	DPCR 4					DPCR 5				
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Outturn (target losses - actual)	A	B	C	D	E					
Incremental change (05-06)	A	A	A	A	A					
Incremental change (06-07)		B-A	B-A	B-A	B-A	B-A				
Incremental change (07-08)			C-B	C-B	C-B	C-B	C-B			
Incremental change (08-09)				D-C	D-C	D-C	D-C	D-C		
Incremental change (09-10)					E-D	E-D	E-D	E-D	E-D	
Net change	A	B	C	D	E	E-A	E-B	E-C	E-D	
Total Net Change =	A+B+C+D+E+(E-A)+(E-B)+(E-C)+(E-D)									
	= 5 x E									

Figure 4.1 – Example of LRRM

4.14. This means that if $TL_{2009/10}$ is the target losses (GWh) in 2009-10 and $ACL_{2009/10}$ is the reported losses¹¹ in 2009-10 then the total incentive under the LRRM ('total incentive') is calculated as follows:

$$\text{total incentive} = 5 \times \text{IR} \times (TL_{2009/10} - ACL_{2009/10})$$

where

- $IR = \text{PIAL}_{2009/10} \times \text{LR} \times 1000$
 - PIAL is the price indexation adjustment
 - LR is the losses incentive value, which was £48/MWh for DPCR4
- $TL_{2009/10} = \text{ALPDPCR4} \times \text{LUD}_{2009/10}$
- ALP is the Allowed Loss Percentage (i.e. the target percentage, %)
- LUD is the units distributed (GWh) in the final year excluding any corrections to prior years, but with subsequent settlement corrections to the final year added in.

4.15. [Text deleted]

4.16. [Text deleted]

4.17. [Text deleted]

Close out of DPCR4 losses incentive


4.18. As stated in Chapter 7, in closing out the DPCR4 losses incentive we intend to apply the LRRM (as described above) and to take steps to ensure that there are no windfall gains or losses to the DNOs arising from:

- settlement data corrections and provision accounting, [text deleted]

Adjustments arising from settlement corrections and provision accounts

4.19. As stated in Initial Proposals we will require the DNOs to report corrections to the DPCR4 losses that take place after the end of the DPCR4 period, so that all the settlement data associated with DPCR4 has been accounted for and the DPCR4 annual reported losses have been revised accordingly. This includes subsequent corrections to DPCR4 settlement data and the 'closing out' of DPCR4 provision

¹¹ subject to adjustments as described in paragraph 4.19 and 4.20 below



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accounts. As we stated, this will ensure that all DNOs receive the losses incentive based on their absolute losses performance over DPCR4 and ultimately, that rewards/penalties under the DPCR4 scheme are not influenced by the different reporting bases that companies used.

4.20. However, the final year losses reported by the DNOs will probably include corrections in settlement data for prior years. In order to ensure that the LRRM works correctly, the final year losses figure adjusted in paragraph 4.17 above will exclude any corrections to prior years.

4.21. Therefore we will determine $ACL_{2009/10}$, the reported losses in the last year of DPCR4, as the losses experienced in the final year, excluding any corrections to prior years, but with subsequent settlement corrections to the final year added in (including provision account adjustments to provide the actual final year losses). We will also determine $LUD_{2009/10}$ as the units distributed in the last year of DPCR4 excluding any corrections to prior years, but with subsequent settlement corrections to the final year added in.

Adjustment arising from the new methodology

4.22. [Text deleted]

4.23. [Text deleted]

4.24. [Text deleted]

Adjustment arising from the DPCR5 targets

4.25. [Text deleted]

Close out calculation

[Note – the following calculation has been amended to remove all links to the DPCR5 losses incentive mechanism.]

4.26. In calculating the remaining amount owed to/by the DNOs (the 'close out' amount) we will then subtract the loss incentive amounts already included in the DPCR4 allowed revenues:

$$\text{close out} = \text{total incentive} - \Sigma \text{incentive over DPCR4}$$

where

Σ incentive over DPCR4 is the sum of 'Incentive for Units distributed after 1.4.2005' from 2005-06 to 2009-10 as reported in the DPCR4 revenue returns.

DPCR5 LRRM

4.27. [Text deleted]



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4.28. [Text deleted]

4.29. [Text deleted]

4.30. [Text deleted]

4.31. [Text deleted]

4.32. [Text deleted]

Overall cap and collar close out

4.33. [Text deleted]

4.34. [Text deleted]

4.35. [Text deleted]

Spreadsheet example

4.36. [Text deleted]

4.37. [Text deleted]

4.38. [Text deleted]

4.39. [Text deleted]

4.40. [Text deleted]

4.41. [Text deleted]

Appendix 2: Paragraphs deleted from DPCR5 Final Proposals

In addition to the chapters replicated above, this Appendix lists the remaining paragraphs of Final Proposals that have been nullified or amended by our decision not to activate the losses incentive mechanism for DPCR5. (As with the above text, the original paragraph numbers have been retained for clarity.)

[Original Document: Electricity Distribution Price Control Review Final Proposals - 144/09]

Fully deleted:

Paragraph 1.25.

Partially deleted to remove reference to outputs-based losses incentive:

The following text has been deleted:

From Paragraphs:

- 1.41. 'and the losses incentive' from the second bullet point
- 2.6. 'include several revisions to the DPCR4 losses incentive to make it more effective and proportionate. We also propose to '
- 2.11. 'losses incentive and the'
- 2.14. 'The two key features of the revised losses incentive are as follows:',
and:
'Companies will then be set tougher targets to make sure the investments deliver the losses reductions they claim,
 - We will retain an incentive that rewards or penalises each DNO according to how they perform against a losses target. The incentive will be set at a higher rate of £60 per MWh. We will change the incentive mechanism to remove some of the problems with measuring losses. For example, we will require all DNOs to use a common approach for reporting losses and we will introduce caps and collars in the mechanism, in recognition that performance at the extremes could be driven by other factors. This will mean that DNOs will not be able to earn or lose more than 97 basis points (pre tax) in shareholder returns through the losses incentive, including the five year losses rolling retention mechanism. More detail on the specific revenue caps and collars per DNO is set out in the Incentives and Obligations document.'
- 2.15. 'We also plan to retain enough flexibility in the arrangements so that if any DNO is successful in finding a better way of measuring losses on their network (for example by installing more smart metering

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- equipment on their network), the cap on rewards will be removed and the collar may be tightened further.’
- 4.6. Second sub-bullet of the third bullet: ‘Losses incentive’
- 4.24. First sub-bullet of the first bullet: ‘Placed a tighter collar on the maximum penalty they can pay under the losses incentive from 115 to 70 post-tax bps at Initial Proposals,’

From Table 2.1., the line corresponding to losses as follows:

‘manage an efficient level of network losses // Revised incentive based on an output mechanism // 97 bps // 97 bps’

[Original Document: Electricity Distribution Price Control Review Final Proposals – Incentives and Obligations - 145/09]

Partially deleted to remove reference to outputs-based losses incentive:

The following text has been deleted:

From the main text:

The line referring to losses in the table referred to in paragraph 1.2., as follows:

‘Manage an efficient level of network losses // Revised incentive based on an output mechanism // 97 bps // 97 bps’

In paragraph 8.10.

‘The league table will not include the emissions from losses as they are reported separately.’

Replaced with:

‘The league table will not include losses as they are already covered under the Distribution Losses Reporting Requirement.’

In paragraph 19.1.

‘, network losses’

From Appendix 7, paragraph 1.2.:

‘, network losses’


Chapter 6: Losses

The entirety of Chapter 6 has been deleted, with the exception of the following text, which has been amended as appropriate.

Chapter summary

We propose to fund explicit investments to reduce losses, where justified.

6.9. We propose to provide DNOs with direct recognition of low loss investment.



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6.22. The DPCR4 rolling retention mechanism has caused some concern amongst the DNOs. These concerns focus on the impacts of settlement volatility and a lack of common understanding about how the mechanism would be implemented post DPCR4. This is described further, along with our proposed treatment of the DPCR4 losses rolling retention mechanism, in Chapter 7.

6.31. We want to encourage DNOs to find ways to improve their measurement of losses.

6.32. We also expect DNOs to be proactive in targeting electricity theft, and to work with other industry participants to identify ways to reduce and manage theft, such as introducing modifications to the relevant industry codes and agreements.

[Original Document: Electricity Distribution Price Control Review Final Proposals – Allowed Revenue - Cost Assessment 146/09]

Partially deleted:

The following text has been deleted:

In paragraph 4.93.

'CE's losses targets will be adjusted by their revised forecast of substation electricity usage.'

[Original Document: Electricity Distribution Price Control Review Final Proposals – Allowed Revenue - Cost Assessment Appendix – 146a/09]

Fully deleted:

Paragraph 1.31. of Appendix 5.

Partially deleted:

The following text has been deleted:

Paragraph 1.173.

'We have accepted these forecasts, but have included a corresponding adjustment to the calculation of the DPCR5 losses targets to reflect the fact that these DNOs will have lower losses in DPCR5'

Paragraph 1.194.

'but also increased their losses targets.'