Further consultation on restatement of 2009-10 data and closing out the DPCR4 losses incentive mechanism

Consultation

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Response deadline:	2 December 2013	**Tel:**	020 7901 7350
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Overview:

We have consulted extensively in the past on aspects related to closing out the Losses Incentive Mechanism in the Fourth Distribution Price Control (DPCR4). This mechanism was designed to drive the Distribution Network Operators (DNOs) towards achieving an efficient level of losses on their distribution networks.

In July 2013 we published our decisions on aspects affecting the approach to restatement of losses data, and invited DNOs to resubmit their data. Having carefully considered the data submitted and responses to our decisions, we are now setting out, for consultation, our views on the restatement of losses performance for 2009-10, and the final incentive value under the DPCR4 losses mechanism. We are seeking views on the process for recovery of these monies.

This document also contains decisions on the target to be used in the close out for DNOs with more than one target, indexation of incentives already received and the impact of data restatement on calculation of the growth term in earlier years of DPCR4.

Due to the amount of prior consultation on this issue, this is a six-week consultation. Responses to this document are requested by 2 December 2013 and should be sent to distribution.losses@ofgem.gov.uk. We are also seeking additional evidence to support our assessment of certain issues. We will continue to accept and publish evidence received during the consultation period that assists with consultation responses, including in assessing the evidence already provided.

Context

Electricity distribution losses are an inevitable consequence of transferring electricity across the distribution network. The distribution losses incentive mechanism was designed to drive the DNOs towards achieving an efficient level of losses on their distribution networks. The mechanism in the fifth Distribution Price Control Review (DPCR5) included a process to close out the DPCR4 mechanism. However, significant concerns were raised about the volatility of settlement data, which affected the 2009-10 data in particular, and we established a process to make adjustments to this data prior to determining the DPCR4 close out values.

This document contains both decisions and matters on which we are consulting in relation to (a) a revised restatement of losses performance for 2009-10 and (b) the final incentive value under the DPCR4 losses mechanism.

Associated documents

Key documents in relation to the Losses Incentive Mechanism can be found on our website
https://www.ofgem.gov.uk/electricity/distribution-networks/losses-incentive-mechanism

There are a number of associated documents which have been referenced in previous consultations on this topic, and many are referred to in our 16 November 2012 consultation document. A small selection is presented below:

Decision on the process to follow for closing out the losses incentive mechanism for the fourth distribution price control (DPCR4) - 12 July 2013 (ref 119/13)
https://www.ofgem.gov.uk/publications-and-updates/decision-process-follow-closing-out-losses-incentive-mechanism-fourth-distribution-price-control-dpcr4

Timing of recovery of the close out values of the losses incentive mechanism of the Fourth Distribution Price Control Review (DPCR4) - 25 April 2013
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=836&refer=Networks/ElecDist/Policy/losses-incentive-mechanism

Update on closing out the Losses Incentive Mechanism of the Fourth Distribution Price Control Review (DPCR4) - 19 April 2013
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=835&refer=Networks/ElecDist/Policy/losses-incentive-mechanism

Document G: Consultation on restatement of 2009-10 data and closing out the DPCR4 losses incentive mechanism - 16 November 2012 (ref 150/12)
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=762&refer=Networks/ElecDist/Policy/losses-incentive-mechanism

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Executive Summary

Background

Losses are an inevitable consequence of transferring electricity across the distribution network. Losses can be due to technical reasons, such as transformation losses, or non-technical losses, such as theft. To encourage distribution network companies to manage losses efficiently across their networks, we introduced a losses incentive mechanism. The fourth distribution price control (DCPR4) losses incentive mechanism covered the period from 2005-06 to 2009-10.

Distribution Network Operators (DNOs) calculated their losses by reference to the difference in the electricity flowing in and out of their networks. However, unusually high levels of data cleansing increased the recorded losses for most DNOs for 2009-10. This has had the potential to affect the incentive (penalty or reward) each DNO would receive for 2009-10, as well as the value of the final close out amount for each DNO, which is based on the performance in 2009-10.

Since 2010 we have been extensively involved with industry in seeking to resolve this issue. We have published a number of consultations and decisions on the matter. We continue to believe that where there is sufficient evidence that abnormal levels of settlement data corrections have occurred, allowing DNOs to restate their data is, on balance, in the interest of consumers.

In November 2012 we published a consultation on submissions from DNOs to have their losses positions restated for 2009-10, including draft close out values for all DNOs. Responses to that consultation raised a number of concerns regarding the data submitted as well as the methodology more generally. Following careful consideration of the responses, in July 2013 we published further decisions on some of the issues raised, and we requested that DNOs wishing to apply for restatement of 2009-10 data submit fresh applications based on improved data. In addition we requested that all DNOs resubmit the data necessary to finalise the close out values for the DPCR4 price control period.

This consultation

This document presents an assessment of applications from 11 DNO licensees to have their 2009-10 losses positions restated. We present an analysis of the restatement applications for closing out the DPCR4 incentive mechanism based on the framework set out in the July 2013 document. Under this assessment, the indicative close out values result in an overall reward of between £140m and £183m over the DPCR4 period to those DNOs applying for restatement, compared with a penalty of £334m without any restatement. This assessment is provisional depending on the final decisions made on the issues we are consulting on.

We also present the indicative close out values for the three DNO areas that have not applied for restatement, resulting in an overall reward of £81m. On that basis the overall value of the DPCR4 losses incentive mechanism is a net reward of between £221m and £264m to the DNOs. This is significantly lower than the total reward of £424m that would arise if we were to accept the DNOs' submissions in their entirety. DNOs have collectively already recovered £317m of the total reward. Therefore, based on our assessment, in order to close out the mechanism, DNOs will need to return between £53m and £96m. This is in contrast to the £59m reward left for the DNOs to recover based on our November 2012 consultation.

To calculate these values we have decided that the average target should be used for those DNOs with more than one target over the DPCR4 period. We also reaffirm our decision on the inflation indexation of incentives already received/incurred. We are seeking views on (a) the DNOs' submissions and our assessment of them, and (b) how and over what period the revenue should be recovered.

We have also decided that the impact of the restatement on the growth term should be limited to 2009-10. The growth term is a term in the revenue calculation which depends on the number of units distributed in each year. We are seeking views on the restatement of the growth term for 2009-10 and its recovery.

Responses to this document are requested by 2 December 2013. We are also seeking additional evidence to support our assessment of restatement submissions. We will continue to accept and publish evidence received during the consultation period that assists with consultation responses, including in assessing the evidence already provided. This is subject to such additional evidence being submitted at a point that gives stakeholders sufficient opportunity to consider it ahead of the consultation closing.

1. Introduction

Chapter Summary

This chapter provides a background to the issues covered and explains the structure of the document. The chapter provides a high-level overview of the series of complex issues addressed by this consultation. There are no questions in this chapter.

1.1 This consultation contains decisions that we have made, further policy issues that we are consulting on, and our analysis of the restatement applications and the draft close out values for each DNO. It brings together our analysis of the DNOs' applications for both the restatement of their losses positions for 2009-10 and for the close out of their overall losses incentive for DPCR4. This is a six-week consultation. We have chosen that consultation period taking into account, amongst other things, the long history of DPCR4 losses incentive close out and the close working of Ofgem, industry and our independent auditors in the lead up to this consultation, including earlier formal consultations.

Background

Distribution losses incentive mechanism

1.2 The purpose of the DPCR4 distribution losses incentive mechanism was to encourage DNOs to attain an efficient level of losses on their network.[1] DNOs calculate their losses by reference to the difference in the electricity that flows onto their network and that which flows off their network as units distributed. The measured electricity that flows during any given half-hour is based on a combination of actual and estimated meter readings, recorded for the purpose of settling energy in the market. This is known as settlement data. Under the DPCR4 mechanism, DNOs generally reported their losses annually based on data available at that time (supplemented by estimates if necessary).

1.3 As more meters are read in the period after the energy flows, the measure of the electricity that was actually used should improve. Later data is based on a series of data reports (or reconciliation runs) that relate to any given period. We are particularly interested in the RF (run final) and DF (dispute final) data sets.

Target setting and DNO methodologies

1.4 DPCR4 utilised target losses against which each DNO's performance was measured. Targets for DPCR4 were set for each DNO based on its historical average ten-year losses performance.

[1] DPCR4 covered the period from 2005-06 to 2009-10.

1.5 The performance of each DNO was measured according to the DNOs' own reporting methodologies. Different DNOs have different methodologies. To ensure consistency throughout the price control with the way targets were set, DNOs' reported losses performance was in relation to their particular methodology.[2]

Data cleansing affecting losses performance

1.6 Suppliers may conduct data cleansing activities to correct for errors and improve the accuracy of the settlement system. Any data cleansing activity undertaken by suppliers affects the settlement data used by DNOs to record losses performance. In some cases, these effects can be significant. Further detail is set out at Appendix 4.

1.7 Data cleansing is an ongoing process. However, during 2010 some DNOs noted high levels of data reconciliation corrections. This affected the calculation of the close out position for DPCR4 since 2009-10, the final year of DPCR4, is fundamental for the close out calculation.

1.8 The close out calculation, described in more detail below, is based on five times the incentive value in 2009-10, based on fully-reconciled data, less the five years' worth of incentives already received/incurred during DPCR4 (this is the calculation used to derive the "PPL" term). In short, the close out value determines the final incentive amount incurred/received by each DNO.

Addressing abnormal levels of data cleansing

1.9 Since 2010 we have been extensively involved with industry in seeking to resolve this issue and have allowed DNOs to apply to restate the data in 2009-10 where it can be demonstrated that the data was affected by abnormal levels of data cleansing.[3] In such cases we believe that allowing DNOs to restate their data is, on balance, in the interest of consumers.

1.10 Our November 2012 consultation contained our draft PPL values based on DNOs' restatement applications. These values and the methodology for restatement were criticised in certain consultation responses. Subsequently, we have worked with industry to resolve the issues raised by the consultation responses, and we have considered and improved both the methodology for restatement and the data used in that respect. We give more details on developments since the November 2012 consultation in Chapter 2.

The growth term

1.11 Owing to the design of the close out of the DPCR4 losses mechanism, restatement of losses data for the purpose of the 2009-10 annual losses incentive at this stage is immaterial.

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[2] DPCR4 Special Licence Condition C1(9) – this provided that the licensee should calculate losses on the same basis as that in 2002-03, unless the Authority has agreed otherwise.
[3] More detail can be found on the Ofgem website: https://www.ofgem.gov.uk/electricity/distribution-networks/losses-incentive-mechanism

1.12 However, the Base Demand Revenue[4] calculation includes a growth term which incorporates the change in units distributed for each DNO with respect to previous years. The growth term, which operated under DPCR4, is an incentive mechanism that rewards DNOs for increasing units distributed. Where we consider that justifiable restatement of losses performance is appropriate, the same logic applies for the calculation of the growth term that relies on the same data.

1.13 DNOs whose 2009-10 units distributed were subject to an interim restatement process[5] resubmitted their 2009-10 revenue returns after the interim decisions. The growth term and Base Demand Revenue for 2009-10 for these DNOs were thus recalculated and affected their starting positions for the next (DPCR5) price control period. We consider that any DNO whose 2009-10 units distributed are restated as a result of the current restatement process should also be required to resubmit their (updated) 2009-10 revenue returns to reflect the impact on the 2009-10 growth term.

1.14 The impact of inaccurate data on the growth term for earlier years of DPCR4, identified through the restatement process, has been raised in responses to the November consultation. This issue is addressed in more detail in Chapter 4.

Framework for consideration

1.15 In making our decisions, we have sought to comply with our principal objective under s3A of the Electricity Act 1989. In summary, this is to protect the interests of existing and future consumers in relation to electricity and to carry out our functions in a manner which we consider will best promote effective competition in the generation, transmission, distribution or supply of electricity. We do not set out here the detail of the statutory provisions, but in this document we have applied the requirements set out in that section.

1.16 In the context of this decision, we consider that we should carry out our functions in a manner that we consider is best calculated to promote efficiency and economy on the part of DNOs and the efficient use of electricity conveyed by distribution systems. In seeking to discharge our statutory duties, we have had regard to the criteria we set out in our 9 March 2012 decision letter, repeated below.

- The purpose of the distribution losses incentive mechanism, which is to drive the DNOs towards achieving lower levels of losses on their distribution networks.

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[4] DPCR4 Special Licence Condition B1.
[5] Two DNO groups (Electricity North West Limited (ENWL) and Northern Powergrid) obtained interim restatement of their 2009-10 units distributed, prior to the further process. This was more fully covered in prior documents: https://www.ofgem.gov.uk/publications-and-updates/interim-decision-request-electricity-north-west-ltd-enwl-consent-calculate-distribution-losses-2009-10-basis-differs-used-2002-03 and https://www.ofgem.gov.uk/publications-and-updates/decision-request-ce-electric-uk-consent-restate-losses-information-2009-10

- The principle that restatement in any given instance, will only be appropriate where the Authority is satisfied that there is a defect in the way in which the mechanism would operate in the event that restatement were not to be allowed, for instance by creating an inconsistency between target setting and performance monitoring.

- The need to ensure equality of treatment of licensees, with any difference in treatment between licensees being objectively justified.

- The desirability of promoting regulatory certainty, for the benefit of industry and the public.

- Our assessment of the merits of addressing any particular defect and the qualities of the methodologies proposed to achieve this, for instance, the relative accuracy of the data that results from the adjustments.

- We have also considered the degree of transparency, fairness to customers, the appropriateness of assumptions and the ease of audit.

Structure of this document

1.17 Chapter 2 gives a view of our progress and any developments since the November 2012 consultation. This chapter also **consults** on our views on the normal period and credibility cap as set out in our July 2013 document.

1.18 Chapter 3 covers our analysis with respect to the close out values of the DPCR4 losses mechanism and **seeks views** on the restatement and close out values (PPL) for each DNO as applicable.[6] It **seeks views** on an appropriate period for recovery in light of the draft PPL values contained within this consultation and the relevant indexation to be applied to the PPL terms. This chapter also contains **decisions** on the target to be used for DNOs with more than one target during the period and indexation of incentives already received.

1.19 Chapter 4 provides analysis for the 2009-10 annual incentive and **seeks views** on the impact of restatement on the growth term and the process for recovery. This chapter also contains a **decision** on the amendment of the growth term for years prior to 2009-10. Chapter 5 sets out the next steps.

1.20 Alongside this consultation we have published all submissions from DNOs in response to the July 2013 document. In the coming days we will publish the accompanying report from our independent auditors.

1.21 Appendix 1 contains a DNO-by-DNO analysis of the data submissions for close out, Appendix 2 presents an impact assessment of the close out values, and Appendix 3 sets out the draft calculations. Appendix 4 provides further background.

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[6] The PPL term is the residual value of the DPCR4 losses incentive mechanism as a result of the close out calculation.

2. Developments since the November 2012 consultation

Chapter Summary

This chapter outlines the process we have followed since the November 2012 consultation alongside detail of developments in our views/policy. It seeks stakeholder views on the restatement process, including the normal period, credibility cap and reciprocal cap.

Question box

Question 1: Do you have any views on whether any DNO should be able to use a different normal period based on strong evidence that 2006-07 and 2007-08 are inappropriate? What evidence should be considered?
Question 2: Do you have any views on the suitable normal period to be used should a DNO demonstrate, based on evidence, that the stipulated normal period is inappropriate for the restatement process?
Question 3: Do you have any views on the application of the proposed credibility cap in relation to the restatement applications for both the annual incentive and the close out?
Question 4: Do you have any views on the suitable normal period to be used in the credibility criteria should a DNO convince us that the stipulated normal period is inappropriate for the restatement process?
Question 5: Should we allow additional evidence for demonstrating abnormality for post 2009-10 years where a DNO fails the statistical test for these years (ie treat post 2009-10 years in the same way as 2009-10)?
Question 6: Do you consider that permitting restatement, based on exceeding the reciprocal cap thresholds with fully-reconciled un-restated data for 2009-10, is a fair and appropriate means of protecting consumers and DNOs from unreasonable outcomes in the close out process?
Question 7: Do you consider that 'reported-equivalent' data compared with the reciprocal cap should be applied to post-2009-10 years as evidence that contributes to a case for identifying abnormality in those years?

We will continue to accept and publish evidence received during the consultation period that assists with consultation responses, including in assessing the evidence already provided. This is subject to such additional evidence being submitted at a point that gives stakeholders sufficient opportunity to consider it ahead of the consultation closing.

The November 2012 consultation

2.1 The November 2012 consultation invited views on the approach to closing out the losses incentive mechanism in DPCR4. It presented our draft positions on restatement of losses performance for both the 2009-10 annual incentive and for the final incentive value under the mechanism.

2.2 Respondents to the November consultation raised a number of issues, including concerns over the credibility of the underlying data used and the application of suitable statistical tests to identify abnormality in 2009-10 (and later years). In seeking to address these issues we appointed independent data experts to examine the underlying data, and we commissioned a separate independent critique of the statistical analysis.

The data audit

2.3 Our independent auditors examined the underlying data to consider:

- Area 1 – Differences between fully-reconciled data provided by DNOs and other records of settlement data.
- Area 2 – Inconsistencies between the data reported by DNOs in annual revenue returns and that supplied for close out.

2.4 The auditors provided a report which was published on the Ofgem website.[7]

2.5 As a result of the consultation responses, data audit and subsequent industry discussions, we made some decisions about the DNOs' data in a document published on 12 July 2013 (the July 2013 document). These decisions were necessary in order for DNOs to submit appropriate data for calculating the draft PPL terms presented in this consultation.

Review of statistical analysis and the restatement process

2.6 In light of responses to the November consultation we commissioned an independent critique of our approach to the statistical analysis. We also re-examined the application of the SP methodology[8], our assessment of credibility and the calculation of the cap. The results of this review were presented in the July 2013 document.

The July 2013 document

2.7 On 12 July 2013, we requested a fresh set of close out and annual incentive data from all DNOs. In addition, we requested new restatement submissions from those DNOs wishing to apply for restatement of 2009-10 data for close out or for the annual incentive, where they can demonstrate abnormal levels of data cleansing activity affected 2009-10 losses levels. The July 2013 document contained some methodological decisions resulting from the data audit so that we could request appropriate data.

[7] https://www.ofgem.gov.uk/ofgem-publications/82858/esplossesdataauditreportdpcr4.pdf
[8] The SP methodology was developed by Scottish Power and Engage Consulting as a means of recreating the reported data for 2009-10 in the absence of abnormal levels of data cleansing.

2.8 As explained in the July 2013 document we decided that Approach C[9] represents the most appropriate way to close out the DPCR4 losses mechanism for those DNOs seeking restatement. We therefore requested that DNOs submit restatement applications consistent with Approach C only.

2.9 To enable DNOs to apply Approach C the following decisions were made (additional detail is provided in the July 2013 document).

- Those DNOs applying for restatement should apply on a basis consistent with the settlement run historically reported by each DNO (DF for all DNOs except ENWL which should use RF)[10].
- We consider that DNOs may remove the effect of provisions prior to looking for abnormality for close out since such forecast units may disguise the existence of subsequently identified abnormality and indeed have to be removed for close out purposes. Reasons should be given for departure from annual reporting.
- Normalisation of SF (SF adjustment) prior to abnormality testing remains valid for the restatement for close out. For the annual incentive, the SF adjustment should only be applied prior to abnormality testing if that DNO uses settlement data directly[11].
- We decided to introduce a single, more robust, test to be used for identifying abnormality in 2009-10 data. DNOs unable to identify abnormality using the test may submit other evidence, both quantitative and qualitative, to demonstrate that they have been affected by abnormal data corrections in 2009-10.
- DNOs should use the weighted average of monthly data to adjust the SF loss percentages for each month rather than use a single average weighted figure for all the months.
- DNOs should calculate the abnormal reconciliations in 2009-10, using monthly weighted average percentage natural variation as a percentage of SF for each run type.
- SF 'normalisation mapping', in accordance with the SP methodology, should be applied to the SF adjustment before testing for abnormality.

2.10 The July 2013 document also set out our minded-to position on the operation of the cap and credibility criteria, known simply as the credibility cap, which is considered in more detail in this chapter.

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[9] Approach C was one of four approaches to restating data for close out developed with industry. More details are available in our November 2012 consultation.
[10] RF and DF are respectively the penultimate and last updates to settlement data for any given period (see Glossary).
[11] SF is the initial settlement run. The SF adjustment is designed to recognise the impact of both the prevailing economic conditions and of any data cleansing earlier in the period on the SF position.

2.11 The July 2013 document also stipulated a common normal period (2006-07 and 2007-08) both for the SF adjustment and for the abnormal reconciliations adjustment. This chapter seeks further views on the application of this normal period to all DNOs. More detail on this issue is contained below. Further details on the application of Approach C are contained in Appendix 3 of the July 2013 document.

2.12 The July 2013 document also clarified what data DNOs should be using as a result of the data audit.

2.13 Chapters 3 and 4 and Appendix 1 consider the results of our assessment of the submissions we received. We have published DNOs' applications on our website alongside this consultation.

The normal period

2.14 Concerns raised in response to the November 2012 consultation, as well as our own concerns, led to our reassessment of the selection of the normal period.

2.15 We decided to stipulate 2006-07 and 2007-08 as the normal years to be used by all the DNOs, both for the SF adjustment and for the abnormal reconciliations adjustment.[12] As a consequence, DNOs do not have to use statistical means to identify a suitable normal period.

2.16 We made this decision to help ensure equitable treatment of DNOs. We considered that this decision addressed both our concerns and the concerns raised in the November consultation responses, as it removes DNOs' discretion over the choice of a normal period and the risk of 'cherry-picking' by DNOs to select whichever normal period would give them the best result.

2.17 We chose this period on the basis of evidence from the aggregate data reconciliations that these two years best display 'normality' across the DNOs. That is, on aggregate, the reported data for these years does not appear to have been affected by unusual levels of data correction activity. We excluded 2005-06 because, on aggregate, for reported data, this year displayed unusually positive reconciliations compared with other years of DPCR4.[13] We excluded 2008-09 as it is itself subject to the SF adjustment.

2.18 We had previously stated in our March 2012 decision letter that the normal period must be at least two years in length and occur within the DPCR4 period due to the unreliability of some data for prior years (particularly over short time periods). This left only 2006-07 and 2007-08 suitable for use as the normal period.

2.19 Given the limited sample size (of five DPCR4 years), we consider that selecting a common normal period is the fairest approach to ensuring equitable

[12] These adjustments are an integral part of the SP methodology.
[13] On aggregate, the level of positive adjustments to initial settlement data (SF), so called positive reconciliations, in 2005-06 was far lower than that of negative reconciliations in 2009-10.

treatment across the DNOs. In light of the uncertainties, we consider that it is fairer (and in consumers' interests) to exclude the possibility of DNOs selecting whichever period would provide them with the best outcome under the restatement process.

Response to July 2013 decision

2.20 In response to our July 2013 decision, some DNOs have argued that they had not been given adequate opportunity to fully explore the impact of the decision on the normal period on their restatement position. They further contended that there could be reason for some licensees to use a different normal period.

2.21 We remain of the view that it is appropriate to stipulate 2006-07 and 2007-08 as the common normal years to be used by all the DNOs, both for the SF adjustment and for the abnormal reconciliations adjustment. We also believe that this is the appropriate normal period for the credibility cap.

2.22 However, we recognise that the stipulation of a common normal period could in principle be unfair for one or more particular licensees. We will therefore consider (along with any other responses) any DNO's presentation of strong additional evidence which would support using a different normal period to assess a particular licensee's restatement application. Any such evidence would need to meet two overarching principles: that the normal period chosen (a) falls within the DPCR4 period and (b) does not include historically low, one-off, losses levels.

2.23 DNOs would also need to provide strong evidence to demonstrate that fully-reconciled losses based on the normal period of 2006-07 and 2007-08 are inappropriate for setting one of the thresholds of the credibility cap.

2.24 **We are seeking views on whether any particular DNO should be able to seek an exceptional normal period, by providing strong evidence to support the selection of a different normal period for that DNO, while still meeting the overarching principles. We are further seeking views on what may constitute robust evidence for this purpose.**

Identification of abnormality

2.25 In the July 2013 document we decided to introduce a single, more robust, test to be used for identifying abnormality in 2009-10 data to address concerns raised in response to the November consultation

2.26 The revised test is a fixed confidence interval test based on the t-distribution. We refined the test so that the average of 2009-10 monthly reconciliations is compared against the average of monthly reconciliations for the remainder of the DPCR4 period.

2.27 We provided a template for applying the test as part of the data request in our July 2013 document. A DNO is eligible for restatement of 2009-10 data if it passes this test.

2.28 We devised this revised test working with an independent consultant as well as seeking further critique from an independent expert. The test we chose was informed by this independent critique. We sought to devise a test that is sufficiently statistically robust to reflect the unusual levels of reconciliations evident in the data, despite the relatively low power of the test owing to the limited sample size.

2.29 We attempted to design a test that is appropriate for these purposes, but it does have inevitable shortcomings. For example, its relatively low power means that it may not fully reflect the extent of abnormal activity affecting some DNOs. This may be the case if, for instance, unusually high levels of data cleansing activity also affected years in the earlier part of DPCR4.

Other evidence

2.30 In our July 2013 document we stated that DNOs unable to identify abnormality using the test may submit other evidence, both quantitative and qualitative, to demonstrate that they have been affected by abnormal data corrections in 2009-10. This was to address some of the potential shortcomings of the test highlighted above.

2.31 We gave examples of the potential evidence, including CUSUM[14] charts to demonstrate the overall trend in the data, and reports, from the period, documenting the abnormal data cleansing activities and/or their effects. We stated that we will only consider this additional evidence where the DNO provides clear justification of its case.

2.32 We also indicated that we are considering applying a further credibility check to ensure DNOs are not unfairly treated in the restatement process. This would apply where a DNO does not pass the abnormality test, but provides some other evidence to demonstrate it has been affected by abnormal levels of data correction activity.

2.33 The July 2013 document outlined the two thresholds, reciprocal to those in the credibility cap detailed in the next section: 5 per cent above the DPCR4 target; and 5 per cent above the normal period losses. If the un-restated losses for 2009-10 are above both of these thresholds, then that DNO may be permitted to apply for restatement (any such restatement would be subject to the credibility cap common to all restatement applications).

2.34 We would like to clarify that the un-restated losses for comparison against the reciprocal thresholds should be based on fully-reconciled data. That is because fully-reconciled data for 2009-10 dictates the overall outcome for each DNO should it not be eligible for restatement.

2.35 In our July 2013 document we limited consideration of the additional evidence of abnormality to 2009-10. In response to the July data request, one DNO group, Western Power Distribution (WPD), provided evidence for 2009-10, while two DNO

[14] CUSUM charts display the magnitude of settlement reconciliations (in terms of units of energy) over time, on a cumulative basis.

groups (Northern Powergrid (NPg) and WPD) provided evidence for abnormality for post 2009-10 years. The evidence provided is explored further at Appendix 1.

2.36 We consider that there is no obvious reason to treat post 2009-10 years in a different way to 2009-10. While identifying abnormality in (and therefore normalising) 2009-10 remains crucial for the restatement process, the normalisation of post 2009-10 years on a reported basis also has a significant impact on the close out position. This is because, with the exception of SP, post 2009-10 years on a reported basis will contain energy that flowed during 2009-10 and therefore should be reconciled back to 2009-10 for the close out process.

2.37 Given the importance of the post 2009-10 years to the final outcome, we are concerned that to use the statistical test for those years in a deterministic way may be unfair given that we have given DNOs opportunities to provide other evidence of abnormality for 2009-10. That is, if the statistical test has some inevitable weaknesses, then these equally apply to post 2009-10 years.

2.38 Therefore, **we are now seeking views on whether we should treat post 2009-10 years in a way that is consistent with our treatment of 2009-10**. That is, whether we should allow a DNO to provide additional evidence of abnormality for post 2009-10 years, where that DNO has failed the statistical test in those years. Though neither of the two DNO groups which provided additional evidence for abnormality in post 2009-10 years addressed this specifically, one piece of evidence that may contribute to the assessment could be a comparison of 'reported equivalent'[15] data to the reciprocal cap thresholds.

2.39 We have published the additional evidence provided by the two DNOs to support abnormality. At Appendix 1 we include a summary of the evidence provided. We also present, for comparative purposes, the outcomes should the years where additional evidence is provided are found to be abnormal. In addition to the question of principle, we seek views on that outcome and the evidence presented by those DNO groups.

Credibility Criteria and the Cap

July 2013 document

2.40 In response to the November consultation responses, our July 2013 document set out our minded-to position in terms of the credibility cap. The prior credibility test was based on historically low losses during DPCR4 and the cap itself was calculated as the un-weighted average losses for the first three years of DPCR4 on a fully-reconciled basis.

2.41 Based on the responses to the November consultation, we devised a wider credibility cap with the following features:

[15] Given that DNOs stopped reporting at the end of DPCR4, such 'reported equivalent' data could be based on the data collated for post 2009-10 years for the restatement applications.

- taking into account the losses targets that are based on a ten-year time series
- applying the revised criteria for assessing credibility uniformly across all DNOs to ensure equal treatment
- removing the gap between the threshold for credible losses and the cap to be applied
- limiting the exposure of customers by restricting the overall financial rewards of restatement to DNOs within credible limits.

2.42 We did not previously publish credibility criteria in advance of the application process that resulted in the November 2012 consultation. This was to avoid DNOs extracting maximum benefit from the restatement exercise by selecting a normal period most advantageous to them, even if that normal period did not have the strongest justification.

2.43 Now that we have removed the requirement for statistical evidence to justify a normal period, there is only one circumstance where we would apply a cap to a restatement application, namely where a licensee's restatement application identifies abnormality in 2009-10 but the proposed restated performance is not credible.

2.44 The intent of the cap is to recognise that DNOs have been affected by abnormal data cleansing activity, while protecting consumers from unreasonable outcomes from the restatement process. We consider that the revised process for calculating the cap is consistent with these aims.

2.45 We therefore propose that a restated loss percentage would be capped if it is below the thresholds of both of the following criteria:

- **Five per cent less than the target losses percentage**. The principle behind this credibility criterion is that the target loss percentage (calculated using ten-year historical losses) is itself a measure of credibility.
- **Five per cent less than the overall (weighted) losses percentage over 2006-07 and 2007-08 on a fully-reconciled basis**.[16] We have identified that the restated losses percentage for some of the DNOs may result in significantly lower losses than those during the normal period. This criterion helps to protect consumers from unreasonable outcomes from the application of the SP methodology. The SP methodology can only estimate losses by removing abnormal correction activity; it does not remove the underlying data volatility that affects settlement data.

2.46 If a DNO fails this credibility test, then we propose that its losses will be capped at the lower of the two losses percentage thresholds. This approach ensures

[16] Fully-reconciled means to the same level of reconciliation as historically used by the DNO during DPCR4.

that the cap is applied consistently across the DNOs. Where it is applied, the cap would become the restated value of losses performance in 2009-10.

2.47 The two thresholds address concerns that some DNOs recorded unusually low losses in the early years of the DPCR4 period that they have been unable to sustain. This is in contrast to the previous credibility check against losses levels reported earlier in the DPCR4 period. They also serve to limit the exposure of consumers to the natural volatility of settlement data that is not addressed in the restatement process.

2.48 The 5 per cent margin is informed by the practical limits to how much DNOs can reduce losses over short timescales. In particular, we analysed the annual performance of all DNOs for the ten years (1994-95 to 2003-04) that were the basis of target setting for DPCR4. Our analysis indicated that around 20 per cent of the time DNOs outperformed the target by more than 5 per cent. We consider that these thresholds are valid in balancing fairness in the outcome of the restatement process to both consumers and DNOs.

Credibility with respect to the target

2.49 In terms of the target, while outperformance to this degree is not exceptional in statistical terms, we feel that it reflects what is plausible in terms of performance in the absence of abnormal levels of data cleansing and what is reasonable in terms of protecting consumers from unusually low restated losses. This is particularly important given the monetary value attached to the losses incentive for the close out of DPCR4.

Credibility with respect to the normal period

2.50 Our selection of the normal period as part of the credibility criteria was informed by our analysis showing that the unusually low losses that DNOs have struggled to sustain generally relate to 2005-06. Not only does this credibility threshold exclude 2005-06 altogether, it is based on two years of data from the middle of this period, effectively diluting any single year with unusually low losses. Furthermore, the losses in the two years are based on a fully-reconciled basis, ie on data that has displayed far more consistency year-on-year than reported data.

2.51 We consider that a threshold of 5 per cent below the losses performance in the normal period is valid because restatement is designed to reveal the losses levels in the absence of abnormal data cleansing. It is possible that the underlying level of losses would be lower in 2009-10 than in the normal period. We consider that the threshold of 5 per cent below the normal period is a reasonable way to limit consumers’ exposure given that the restatement process can only result in an estimate and that there is therefore an inevitable risk of some over or under recovery by DNOs and some over or under payment by consumers. The cap is intended to limit the exposure to these risks whilst retaining the effect of the mechanism (and the regulatory settlement that it reflects).

2.52 We consider the approach outlined is a pragmatic response to the cap calculation that ensures credibility of final performance. We proposed to calculate the credibility cap for the annual incentive in a way that is consistent with that used for the purposes of close out.

2.53 Our assessment of DNOs restatement submissions in this document includes the assessment of the credibility cap as outlined above (in accordance with the July 2013 document). This chapter includes questions that seek views on the application of the credibility cap to the restatement submissions.

2.54 DNOs would also need to provide strong evidence to demonstrate that fully-reconciled losses based on the normal period of 2006-07 and 2007-08 are inappropriate for setting one of the thresholds of the credibility cap.

2.55 **We are seeking views on the application of the credibility cap to the restatement applications, for both the annual incentive and the close out.**

2.56 **We are also seeking views on the suitable normal period to be used in the credibility test should a DNO convince us that the stipulated normal period is inappropriate for the restatement process.**

Further data audit

2.57 Once the data was received from DNOs, we asked our auditors to confirm whether the data submitted was what was expected as a result of the previous audit and July 2013 document. We also addressed concerns raised in response to the findings of the previous data audit, notably SVA units entering[17] and IDNO errors.[18]

2.58 The data auditors reported to us on the outcome of this process:

- SVA units entering – we consider the auditors have a reasonable and proportionate approach to the differences found in units entering. We concur that it is most likely that the difference is explained by export showing up on SVA meters that is not recognised as export by the DNO. We concur with the auditors and we are satisfied that there are legitimate reasons for the differences between settlement and DNO billing data and that, across the DNOs, the scale of the differences would appear to be at reasonable level. Therefore, we reiterate our decision to accept these as reconciling items.
- IDNO error – We consider that the auditors' approach to estimating the potential errors from IDNOs is reasonable and proportionate. The size of the error for the WPD West Midlands licensee is considerable, and we therefore asked the auditors to look into this in more detail. The audit report published alongside this consultation contains more information, but the consequence of this additional analysis is that the auditors remain comfortable with attributing the present value to this error.

[17] SVA units entering are units entering the distribution system that are measured in respect of Supplier Balancing Mechanism Units (Supplier Volume Allocation) for the purposes of the electricity settlement system.
[18] IDNOs are Independent Distribution Network Operators.

2.59 This further audit also brought up additional issues that we have resolved bilaterally with the DNOs. A summary of these issues is below.

- Use of the 10 GWh limit to reconciliation with settlement, for years prior to 2009-10 without a forensic audit (UK Power Networks (UKPN)).
- UKPN's approach to including units found in post-DPCR4 years that relate to energy flowing in 2009-10.
- Inclusion of provisions in annual incentive data (UKPN).
- Removal of provisions and other estimates from reported data, where appropriate, prior to restatement (UKPN, WPD and ENWL).
- Inclusion of CT adjustments (WPD).

2.60 Additional detail can be found in the further data audit report to be published in the coming days, as well as the sections on each DNO in Chapters 4 and Appendix 1 of this document. Appendix 1 also specifically addresses the relevant DNO responses to our decisions on the contentious issues raised by the data audit highlighted in the July decision.

2.61 We are now satisfied that the data provided is sufficiently robust and fit for purpose.

3. Close out of DPCR4: Draft PPL terms

Chapter Summary

This chapter contains DNOs' restatement submissions for close out in response to the July 2013 document and an assessment of those submissions against the framework set out in that document. It presents the DPCR4 close out values for each DNO, on which we seek views. These values may change depending on the outcome of issues on which we are consulting. This chapter also includes our decisions on the indexation of incentives and the target to be used for DNOs' with more than one target in the DPCR4 period.

Question box

Question 1: Do you have any comments on the submissions from DNOs?
Question 2: Do you consider that DNOs have fulfilled the requirements set out in our July 2013 document?
Question 3: Do you have any comments on our assessment of the submissions?
Question 4: Do you have any comments on the steps we have taken to calculate values of the draft PPL terms?
Question 5: Do you agree that the cap has been applied equitably to relevant parties? Please provide evidence to support your argument.
Question 6: Do you consider that, more generally, the approach and calculations have been applied equitably in all circumstances?
Question 7: Do you have any views on the appropriate period for recovery of the PPL based on the draft PPL terms?
Question 8: Do you have any views on the way that indexation and the weighted-average cost of capital (WACC) should be applied when the close out values are recovered?

Views on the normal period and the application of the credibility cap are requested in Chapter 2.

We will continue to accept and publish evidence received during the consultation period that assists with consultation responses, including in assessing the evidence already provided. This is subject to such additional evidence being submitted at a point that gives stakeholders sufficient opportunity to consider it ahead of the consultation closing.

Background

3.1 As part of the DPCR4 losses incentive mechanism, we introduced a five-year losses rolling retention mechanism (LRRM), which we also refer to as the DPCR4 close out calculation. The DPCR4 LRRM was designed to encourage loss reduction initiatives to be undertaken throughout the price control period. The full detail of this is contained in the DPCR5 Final Proposals.[19]

3.2 DNOs have been receiving/incurring annual rewards/penalties during DPCR4 based on reported losses performance against their targets. While these incentives are not returned per se, they are netted off relative to performance in 2009-10 in the calculation of the close out value. Therefore, performance in 2009-10 is critical in calculating the overall value of the incentives received/incurred by DNOs over DPCR4.

3.3 The close out calculation for DPCR4 derives the final losses incentive for each DNO for the price control period. This value is referred to in the licence as the PPL term. The close out calculation, used to derive the PPL term, can be broken down into two parts as follows:

- five times the close out incentive value in 2009-10 (referred to as 5xE), less
- the sum of incentives received/incurred from 2005-06 to 2009-10.[20]

3.4 E is the losses performance in 2009-10 on a fully-reconciled basis. The five times E component is the main focus of this chapter, as it drives the principal outstanding component in the calculation of the PPL term: the units distributed, and consequently the reported losses in 2009-10. The calculation of this component is based on fully-reconciled settlement data so that the value of the incentive is based only on energy that flowed during DPCR4, with adjustments that are in accordance with the DNOs' methodologies.

Targets to be used in the close out calculation

3.5 The value of ALP_{DPCR4} (annual loss percentage target) for each licensee is set out in Annex A to Special Condition C1.[21] However, in accordance with paragraphs 7 and 8 of that condition, the value was changed for four licensees during the DPCR4 period. These licensees were Southern Electric Power Distribution (SSES), Electricity North West Ltd (ENWL), Scottish Power Manweb (SPMW) and Scottish Power Distribution (SPD). This section provides our decision on the value of ALP_{DPCR4} that those licensees should use in the close out calculation. Other DNOs are unaffected by this issue.

3.6 In the November consultation we set out our provisional decision that we should aim to set a value of ALP_{DPCR4} which would be in line with what the values should have been if there had not been any need to change these values. All responses to the consultation on this point supported our approach. Therefore we

[19] https://www.ofgem.gov.uk/ofgem-publications/45537/methodology-closing-out-dpcr4-losses.pdf
[20] Any incentive for one-off performance over the period is effectively clawed back.
[21] Since Special Condition C1 is specific to each DNO a generic reference is not available, however the discrete conditions can be found on the Electronic Public Register: http://epr.ofgem.gov.uk/

have decided that the average ALP should be used in each case. The details of this for each DNO are set out below.

ALP for Scottish & Southern Energy (SSE): SSES

3.7 In May 2007, SSES identified and informed the Authority of errors in the data used to calculate the ALP for DPCR4. Specifically, SSES identified units which were incorrectly included as part of the adjusted system entry volumes when calculating the ALP for DPCR4. SSES provided revised figures and corrected calculations which illustrated that the correct DPCR4 ALP should have been set at 6.68 per cent.

3.8 The Authority considered the information provided by the licensee and agreed that SSES's DPCR4 ALP should be altered to 6.68 per cent. To avoid retrospectively adjusting previous years, Ofgem adjusted SSES's ALP from 6.74 per cent to 6.59 per cent with effect from 1 April 2008 as set out in the Direction on SSES dated 2 July 2007.

3.9 **Our decision is that, since the SSES Direction was explicitly made in order to emulate a revised ALP value of 6.68 per cent over the whole of the DPCR4 period, that this figure should be used in the close out calculation.**

ALP for Electricity North West Limited (ENWL)

3.10 In May 2006, ENWL (then United Utilities Electricity plc) identified data errors relating to system entry volumes that originated prior to the DPCR4 period, which affected the setting of their DPCR4 target. A Direction of 24 August 2006 changed ENWL's ALP from 5.68 per cent to 5.48 per cent from 1 April 2007 for the remainder of the period. This reflects and accounts for the fact that, had the errors not been made, the target for the DPCR4 period would have been set at 5.56 per cent.

3.11 **Our decision is that ENWL should use the value which would have been applied, had errors not occurred, ie 5.56 per cent.** This represents the average of a target of 5.68 per cent for two years (2005-06 and 2006-07) and a target of 5.48 per cent for the remaining three years (2007-08 to 2009-10).

ALPs for Scottish Power Energy Networks (SP)

3.12 In 2005-06 we conducted an investigation into SP's regulatory submissions under the losses incentive scheme relating to the previous price control period (DPCR3). Enquiries showed that the reporting approach had affected reported losses, leading to unduly high ALPs for both Scottish Power: Manweb (SPMW) and Scottish Power: Distribution (SPD) for DPCR4. The investigation concluded with an agreement to reduce the ALPs for SPMW and SPD.

3.13 In October 2007 SP requested a further review of the setting of the ALPs, and after an extensive review process the Authority issued their further Decision in July 2009. The effect of this decision differed for SPMW and SPD.

ALP for Scottish Power Manweb (SPMW)

3.14 Based on the investigation in 2005-06, the ALP for SPMW was revised from 7.52 per cent to 5.85 per cent for 2005-06 (based on information which ought to have been available at the time of setting the target), and a further reduction to 5.32 per cent for 2006-07 to 2009-10 (based on information available at the time of the investigation). The July 2009 Decision concluded that the ALP for SPMW set in the first review would not be changed again.

3.15 In line with our overall approach, **we have decided that the ALP to be used in the close out calculation for SPMW should be that which would have applied had errors not occurred**. This represents the average of a target of 5.85 per cent for one year (2005-06) and a target of 5.32 per cent for four years (2006-07 to 2009-10), which results in an average ALP of 5.43 per cent.

ALP for Scottish Power Distribution (SPD)

3.16 **We have decided that the close out calculation for SPD should be based on the average of the higher ALP (one year at 5.64 per cent and four years at 5.34 per cent) of 5.40 per cent.** This approach is consistent with the Authority's July 2009 Decision. The total incentives over DPCR4 to be deducted in the close out calculation are those recorded in the revenue returns as well as the uplift to SPD's base revenue in 2010-11.

Indexation of the incentives

3.17 In our November 2012 document we set out our approach to applying an inflation indexation to the incentives already received over DPCR4. This approach was informed by responses to a consultation question in March 2012. Though we did not seek responses to this position in the November consultation, one DNO disputed our position. The disagreement was that, with regard to incentives over DPCR4, DPCR5 Final Proposals did not reference indexation at all hence none could be applied.

3.18 We have considered this view and continue to consider that the intent of the design would not work if there was no indexation since loss reduction early in the period would receive higher reward than equivalent loss reduction later in the period. **We have therefore decided to maintain our approach** as follows.

3.19 Final Proposals refer to raw energy in illustrating the five times E value. In order to emulate this, we will calculate the close out value in common energy units, using the value of £48/MWh.

3.20 We will then apply Retail Prices Index (RPI)-indexation to adjust the value of the PPL term to 2009-10 prices. We are limiting indexation to this point for the purpose of this document as we are consulting on how indexation and the time value of money beyond 2009-10 should be reflected when the PPL terms are recovered (see paragraph 3.31). The PPL values included in this consultation have been calculated on this basis and are presented in 2009-10 prices.

Restatement for close out

3.21 We received 11 applications[22] for data restatement for close out in response to our letter of 12 July 2013. Two of these applications, for the UKPN licensees London Power Networks (LPN) and South East Power Networks (SPN), had not been submitted previously.

3.22 In reaching a close out figure DNOs needed to address two key clauses of Final Proposals, concerning the removal of provision accounting and full reconciliation of data before closing out DPCR4. The DNOs must also comply with the results of the data audit.

3.23 During our analysis of the applications, we contacted a number of DNOs to ask them to correct original submissions where we, or the data auditors, noted that there had been errors or a misinterpretation of the methodology. This was to allow DNOs to re-run their calculations on the correct basis to ensure that the impact assessment is conducted with accurate and consistent data. The figures submitted remain the responsibility of the applying DNOs.

Summary of assessments for close out

3.24 In the assessment that follows we present a summary table comparing the DNOs' submissions with our assessment based on the decisions and minded-to positions set out in the July document ('Vanilla' assessment). We also present the outcomes including an assessment against the July framework based on accepting abnormality where DNOs have not passed the statistical test for certain years but have provided other evidence for experiencing abnormality in these years. These assessments relate to EMID for 2009-10 ('09-10 abnormal' assessment), and to NPgN, NPgY, WMID and EMID for post 2009-10 years ('post 09-10 abnormal' assessment).

3.25 For each DNO we display which years have been identified as abnormal and therefore subject to normalisation in the DNOs' submissions and in our assessment. For our assessment we present whether or not the credibility cap has been applied. We also present the outcomes under both the DNOs' submissions and our assessment for the following:

- the losses percentage
- the total value of the incentive over DPCR4 (5xE)
- the residual value of the incentive left to be recovered (PPL).

3.26 Figures are presented in 2009-10 values. Appendix 1 includes a more detailed DNO-by-DNO assessment, including any issues addressed following the data audit. We will be publishing the independent audit report on the submissions in the coming

[22] We have published the applications alongside this consultation.

days. The Impact Assessment at Appendix 2 includes additional charts for each DNO area and the overall position. The DNOs' submissions have been published alongside this consultation. We are seeking views from stakeholders on the questions in this document regarding the DNOs' submissions and our assessment.

Table 1 – Summary of close out submissions compared with our assessment based on the framework from the July 2013 document

DNO[23]	Assessment	Years normalised	Cap applied?	Losses (%)	5xE (£m)	PPL (£m)
ENWL	DNO submission	All		4.94%	43.2	0.5
	Vanilla assessment	All	Yes	5.00%	39.1	-3.6
NPgN	DNO submission	All		4.85%	15.7	2.7
	Vanilla assessment	2009-10; 2011-12	No	5.12%	3.5	-9.5
	Post 09-10 abnormal	All	Yes	4.94%	11.7	-1.4
NPgY	DNO submission	All		5.00%	58.8	10.7
	Vanilla assessment	2009-10	Yes	5.59%	20.5	-27.7
	Post 09-10 abnormal	All	Yes	5.59%	20.5	-27.7
WMID	DNO submission	2009-10; 2010-11		5.31%	-24.4	-0.6
	Vanilla assessment	2009-10	No	5.57%	-42.6	-18.8
	Post 09-10 abnormal	2009-10; 2010-11	No	5.31%	-24.4	-0.6
EMID	DNO submission	2009-10; 2010-11		5.78%	-7.1	-70.1
	Vanilla assessment	None	N/A	6.00%	-24.3	-87.3
	09-10 abnormal	2009-10	No	5.84%	-11.6	-74.6
	Post 09-10 abnormal	2009-10; 2010-11	No	5.78%	-7.1	-70.1
SWEST	DNO submission	2009-10; 2011-12		6.35%	25.6	-1.5
	Vanilla assessment	2009-10; 2011-12	No	6.35%	25.6	-1.5
EPN	DNO submission	All		5.04%	128.8	19.5
	Vanilla assessment	All	Yes	5.57%	75.2	-34.1
LPN	DNO submission	All		5.10%	121.5	52.7
	Vanilla assessment	All	Yes	5.53%	84.8	16.0
SPN	DNO submission	All		5.78%	47.8	14.5
	Vanilla assessment	All	Yes	6.14%	24.9	-8.4
SPD	DNO submission	2009-10		5.96%	-32.6	12.6
	Vanilla assessment	2009-10	No	5.96%	-32.6	12.6
SPMW	DNO submission	2009-10		6.16%	-34.4	4.9
	Vanilla assessment	2009-10	No	6.16%	-34.4	4.9

[23] A full list of DNO names appears in the Glossary.

PPL terms

3.27 This section contains the PPL values on which we are consulting. Special licence condition CRC7 of the electricity distribution licences has now been amended such that we are not restricted as to when the PPL term must be directed by and over what period it should be recovered.

3.28 We have calculated the total value of the PPL terms having taken no account of any provision DNOs may have already made in recovering these values in charges in prior years. We continue to intend to take into account DNOs' PPL estimates for years prior to 2015-16 and will consider how the PPL term should be recovered (including its split between the years of recovery) when directing the final values to be recovered by each DNO.

3.29 Table 2, below, contains the total values of the DPCR4 losses incentive mechanism (5xE) for reference. Table 3 shows the residual value of the incentive mechanism (PPL) for comment.

3.30 Both tables present the current DNO submissions and our assessment of the applications based on the framework set out in the July 2013 document under the three different scenarios outlined above ('Vanilla', '09-10 abnormal' and 'post 09-10 abnormal'). The DNO submission figures include the restatement submissions that go beyond the July framework, eg they represent the restatement submissions prior to capping. The tables also include the position from our November 2012 consultation and the un-restated position for comparative purposes.

Table 2 - 5xE values for reference (£m, 2009-10 prices)

DNO Group	DNO	Nov-12	Un-restated	DNO submission	Assessment		
					Vanilla	09-10 abnormal	Post 09-10 abnormal
ENWL	ENWL	43.2	-46.2	43.2	39.1	39.1	39.1
NPg	NPgN	3.3	-24.6	15.7	3.5	3.5	11.7
	NPgY	51.6	-23.2	58.8	20.5	20.5	20.5
WPD	WMID	-38.7	-47.5	-24.4	-42.6	-42.6	-24.4
	EMID	43.5	-24.3	-7.1	-24.3	-11.6	-7.1
	SWALES	-9.6	-10.4	-10.4	-10.4	-10.4	-10.4
	SWEST	24.1	13.0	25.6	25.6	25.6	25.6
UKPN	EPN	99.0	-45.6	128.8	75.2	75.2	75.2
	LPN	89.1	66.5	121.5	84.8	84.8	84.8
	SPN	46.2	22.0	47.8	24.9	24.9	24.9
SP	SPD	-33.9	-120.4	-32.6	-32.6	-32.6	-32.6
	SPMW	-33.2	-103.5	-34.4	-34.4	-34.4	-34.4
SSE	SSEH	66.7	66.7	66.7	66.7	66.7	66.7
	SSES	24.5	24.5	24.5	24.5	24.5	24.5
Total		**375.7**	**-253.0**	**423.8**	**220.5**	**233.2**	**264.1**

Table 3 - PPL values for consultation (£m, 2009-10 prices)

DNO Group	DNO	Nov-12	Un-restated	DNO submission	Assessment		
					Vanilla	09-10 abnormal	Post 09-10 abnormal
ENWL	ENWL	0.5	-88.9	0.5	-3.6	-3.6	-3.6
NPg	NPgN	-9.7	-37.6	2.7	-9.5	-9.5	-1.4
	NPgY	3.5	-71.3	10.7	-27.7	-27.7	-27.7
WPD	WMID	-15.0	-23.7	-0.6	-18.8	-18.8	-0.6
	EMID	-19.5	-87.3	-70.1	-87.3	-74.6	-70.1
	SWALES	-6.0	-6.8	-6.8	-6.8	-6.8	-6.8
	SWEST	-3.0	-14.0	-1.5	-1.5	-1.5	-1.5
UKPN	EPN	-10.3	-155.0	19.5	-34.1	-34.1	-34.1
	LPN	20.3	-2.3	52.7	16.0	16.0	16.0
	SPN	12.9	-11.3	14.5	-8.4	-8.4	-8.4
SP	SPD	11.3	-75.1	12.6	12.6	12.6	12.6
	SPMW	6.1	-64.2	4.9	4.9	4.9	4.9
SSE	SSEH	46.0	46.0	46.0	46.0	46.0	46.0
	SSES	22.0	22.0	22.0	22.0	22.0	22.0
Total		59.1	-569.6	107.2	-96.1	-83.4	-52.5

3.31 The figures calculated above are in 2009-10 prices. We are seeking views on the appropriate period for recovery of the PPL values based on the draft PPL terms. We are also seeking views on the way that indexation and the weighted average cost of capital (WACC) should be applied when the close out values are recovered. We intend to clarify this process in the direction on the final PPL terms.

4. Restatement of losses data for 2009-10 annual incentive

Chapter Summary

This chapter contains our assessment of DNOs' restatement submissions for the annual incentive against the framework set out in the July 2013 document. We seek views on this assessment. It makes a decision that the impact of restatement on the growth term should be limited to 2009-10. It describes the process that all DNOs should follow when updating losses data for the 2009-10 annual incentive and seeks views on the process for recovery.

Question box

Question 1: Do you have any comment on our assessment of the restatement applications for the purpose of the 2009-10 annual incentive and the proposed changes to the growth term figures?
Question 2: Do you have any views on the way that indexation and the WACC should be applied when the changes to revenue as a result of changes to the growth term are recovered?

The 2009-10 annual incentive and the growth term

4.1 As discussed in Chapter 1, the 2009-10 units distributed are also used to calculate the growth term under DPCR4, which can have an impact on DNO revenues. Where we consider that restatement of 2009-10 losses performance is appropriate, we consider the same to be appropriate for the calculation of the growth term (which relies on the same data).

The November 2012 consultation

4.2 In the November consultation we presented our provisional assessment of restatement applications for the 2009-10 annual incentive. We published the financial impact of our provisional assessment.

4.3 Respondents to this consultation raised a number of issues:

- One supplier raised concerns about data used in calculating the growth term for earlier years of DPCR4.
- One DNO suggested that it should also be possible to restate annual returns for 2008-09 to remove the effects of data cleansing on that year.

- Another DNO considered that high voltage units should be excluded from the calculation of the cap as units distributed at this level were unaffected by the restatement application in its case.
- Some respondents considered that the restatement process should be more robust, and that inconsistencies between the assessment for annual reporting and close out should be removed.
- One supplier expressed concerns with the credibility of some of the outcomes, and suggested that capping should be based on fully-reconciled data and should not automatically limit a DNO's financial exposure.

4.4 We have considered these, and further comments as a result of the data audit, that data inaccuracies had been uncovered earlier than 2009-10. These views led to the suggestion that we should potentially allow restatement and require resubmission of annual returns for previous years of DPCR4. The principal impact of this would be on the growth term for previous years.

The July 2013 document

4.5 In our July 2013 document we set out decisions necessary to enable DNOs to complete the data request for the annual incentive. Our revised approach was informed by both the responses to the November consultation and issues emerging through the data audit process. In general we sought to ensure consistency, as far as possible, between the processes for the annual incentive and close out.

4.6 In response to the July 2013 document, all DNOs were required to ensure that the data submitted for the 2009-10 annual incentive was consistent with their historical reporting. Therefore, where provisions had historically been included (or excluded) in annual reporting, they should similarly be included (or excluded) for 2009-10.

4.7 The data audit also uncovered some 'acknowledged errors'. As stated in the July 2013 document,[24] we decided that for all DNOs, any manifest data errors identified for fully-reconciled data should be removed from the equivalent reported data for all years of DPCR4 as appropriate. That is, where manifest errors are identified, the data for all affected years should be corrected in the resubmitted 2009-10 revenue returns.

4.8 The document also set out the approach to be applied to restatement for the annual incentive. We stated that, in testing for abnormality for 2009-10, DNOs should use reported data, which should correspond with that in its annual revenue returns. We also stated that DNOs could only apply the SF adjustment prior to testing for abnormality for the annual incentive if they reported settlement data directly.

[24] See paragraph 2.16.

4.9 We set out that we would apportion the total units distributed to different voltage levels based on the proportions reported in the normal period of 2006-07 and 2007-08.

The impact of changes to units distributed for the annual incentive

4.10 We considered the following factors in reaching our decision on the impact of revising units distributed for DPCR4 years.

- The importance of closing out the price control period consistently with the commercial settlement reflected in the terms of the revenue calculation, and in general, avoiding reopening that settlement. The early identification of data concerns affecting 2009-10 reporting has been the focus of an ongoing process with industry. In contrast, there has been no expectation throughout the process that earlier years of data would be reopened and subjected to a full audit at this time. We consider it would have a negative impact on regulatory certainty to fundamentally reopen the DCPR4 price control.

- The complexity of the interrelationship between the various elements of the revenue calculation (including over time), would mean that we would face real difficulties in seeking to apply an even-handed approach as between DNOs for earlier years.

- The interests of consumers in ensuring that industry participants are not permitted to benefit from upside risk whilst being protected from the downside risk inherent to the regulatory settlement.

4.11 We therefore do not consider that, on balance, there is sufficient justification to undertake a further prolonged process of restatement of data for years prior to 2009-10. **Our decision is therefore that we will continue to limit our consideration to the restatement of data for the 2009-10 annual incentive and the DPCR4 close out. This decision also means that we do not consider it appropriate to recalculate the growth term for years prior to 2009-10.** However, in submitting the data for the 2009-10 annual incentive and calculating the 2009-10 growth term, the corrected data should be used for previous years, including removal of manifest errors (discussed further below).

Assessment of DNO submissions for the 2009-10 annual incentive

4.12 In response to the July 2013 document we received applications for restatement of the 2009-10 annual incentive from 8 of the 14 DNO licensees. This includes all the DNOs that applied for restatement for close out with the exception of the three WPD licensees. Our assessment of the impact based on the submissions is set out in Table 4 in this chapter. We are seeking views on our assessment.

Data issues

4.13 Where manifest data errors have been uncovered through the audit process, we consider that in line with previous practice these errors should be corrected, and any change to the value of the growth term taken into account in the final 2009-10 values. This is consistent with the usual approach when closing out annual revenue returns, where any manifest errors identified in prior years' data would be corrected and the latest revenue return resubmitted reflecting the correction/s.

4.14 UK Power Networks (UKPN) had originally submitted annual returns without the inclusion of provisions for 2009-10. Based on advice from the auditors, our decision is that provisions were part of the practice of UKPN DNOs during the DPCR4 period and as such they should be included in the annual revenue returns. In response, UKPN has reflected this position in its data submission.

4.15 The Northern Powergrid licensees identified errors relating to embedded generation and wheeled units. Based on advice from the auditors, our decision is that these units should be corrected in all years of DPCR4. In response, Northern Powergrid has corrected the data for all years in its data submission.

4.16 Scottish Power has updated it reported data for previous years, replacing provisions with fully-reconciled data in line with its historical reporting methodology.

Restatement assessment

4.17 We have based our assessment of the submissions on the framework set out in our July 2013 document. In that document we stated that we continue to be of the view that a DNO should not be financially penalised through capping in comparison to its un-restated position based on data revised following the audit process. That is, if the restatement process identifies that a DNO's units distributed for 2009-10 should be increased, then it should not be penalised financially due to the way the cap is calculated.

4.18 We are seeking views on the application of the credibility cap to annual incentive data in Chapter 2 of this consultation.

4.19 Table 4 below displays the DNOs' submissions against our assessment based on the decisions and minded-to positions set out in the July document ('Vanilla assessment'). The position from our November 2012 consultation is also presented for comparative purposes.

4.20 The impact is presented in 2009-10 prices. The financial impact is presented as the revenue change relative to the position reported in current revenue returns for each DNO for 2009-10. The table shows that application of the credibility cap would significantly reduce the total impact of restatement of the annual incentive compared with DNOs' submissions.

4.21 We propose that the final values be adjusted for RPI-indexation and the time value of money, using the appropriate rate of WACC, due to the delay in recovery from 2009-10. We are seeking views on this proposal.

Table 4 - Summary of financial impact of annual incentive submissions compared with our assessment based on the framework from the July document

DNO	Nov-12 (£m)	DNO submission (£m)	Vanilla assessment (£m)
ENWL	0.10	0.57	0.57
NPgN	0.25	0.11	0.03
NPgY	-2.39	0.12	-0.43
EPN	0.30	4.56	0.47
LPN	N/A	1.71	-0.02
SPN	N/A	1.39	-0.15
SPD	0.00	0.28	0.28
SPMW	0.72	0.70	0.70
Total	**-1.02**	**9.44**	**1.46**

Notes:
For ENWL, NPgN and NPgY, the change is relative to the interim restatement decisions recorded in 2009-10 revenue returns.
LPN and SPN did not apply for restatement for the November 2012 consultation; their positions are negative due to reinstating provisions for 2009-10 following the data audit.

5. Next steps

Chapter Summary

This chapter outlines the next steps for both the close out and the impacts of the restatement process on 2009-10 annual reporting. There are no questions in this chapter.

5.1 We are seeking responses to the questions in this consultation by 2 December 2013. We will continue to accept and publish evidence received during the consultation period that assists with consultation responses, including in assessing the evidence already provided. This is subject to such additional evidence being submitted at a point that gives stakeholders sufficient opportunity to consider it ahead of the consultation closing.

PPL terms

5.2 On 26 March 2013[25], we set out modifications to the licence condition for directing the PPL term. This modification states: 'The Authority will direct the period over which the value of PPL_t is to be recovered taking account of the date on which the PPL_t direction is made.'

5.3 On 25 April 2013, we published a letter providing further clarity with respect to the timing of recovery of the PPL term. We confirmed that the PPL term would not be recovered in full over the years 2014-15 and 2015-16 but that our current expectation was that 2015-16 would be the first year of recovery.

5.4 We are seeking views on the appropriate period for recovery based on the draft PPL values in this consultation. Following consideration of the responses to this consultation, we will direct the final PPL values and the period over which they will be recovered. We will provide sufficient notice of the value of the PPL terms in advance of setting forecast charges.

Impact on the growth term

Updating 2009-10 revenue returns

5.5 We consider that any updates to 2009-10 data should be applied by means of updating the annual revenue return for 2009-10, to ensure consistency with interim decisions that have already been made on this issue. This also avoids having multiple records of the same data applicable to one year. We acknowledge that this is different from the position set out in our last consultation.

[25] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=834&refer=Networks/ElecDist/Policy/losses-incentive-mechanism

5.6 We are seeking views on how the final values should be adjusted for RPI indexation and the time value of money (represented by WACC), due to the delay in recovery from 2009-10. We will make a final decision on the process for recovery following responses to this consultation. At that point we will request that all DNOs who have updated data for the annual incentive resubmit their 2009-10 revenue returns, reflecting the updated units as agreed as part of the data audit process.

Interest rate adjustment for under and over recoveries of revenue

5.7 DPCR4 licence condition E1 (Charge restriction conditions: supplementary restrictions) provides that where a licensee has over or under recovered on allowed revenue by more than 2 per cent either way, the interest rate adjustment will take on different values. In DPCR5 this adjustment is set out in licence condition CRC 14 (Distribution Charges: supplementary restrictions), and the band has been widened to 3 per cent either way.

5.8 As a result of the final restatement of 2009-10 data, it is possible that a DNO's current position with regard to under or over recovery of revenue could change. This could have the effect of penalising the DNO.

5.9 In a separate process, but related to the decision not to activate the DPCR5 losses incentive mechanism[26], on 10 May 2013[27] we consulted on ENWL's application for relief from the consequences of under recovery of revenue resulting from that decision. Some DNO responses to that consultation indicated that, depending on the impact of the decision on restatement of 2009-10 data and the DPCR4 close out, they could in due course seek relief from the effects of over or under recovery of allowed revenue. We draw this issue to DNOs' attention and make clear that we would consider any such application on its merits.

[26] This decision meant that previous forecasts underlying the determination of charges were changed, aggravating ENWL's position of under recovery in 2012-13 to beyond the point at which a restricted interest rate became applicable.

[27] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=837&refer=Networks/ElecDist/Policy/losses-incentive-mechanism

Appendix 1 – DNO-by-DNO assessment for close out

A1.1 Chapter 3 of the consultation includes a summary assessment table for the close out outcomes for each DNO. This Appendix gives further details on the DNO submissions, addressing data issues and the restatement process. Further charts are available in the Impact Assessment at Appendix 2, while the underlying data is available at Appendix 3. We have published the DNOs' submissions alongside this consultation and will be publishing the independent audit report on the submissions in the coming days. We are seeking views on the DNOs' submissions and our assessment options in the questions in Chapter 3.

Electricity North West Limited (ENWL)

A1.2 In line with our July decision, ENWL has removed the 10 GWh unbilled units and the trading dispute (DA329) from its close out data.

A1.3 Consistent with past restatement applications, ENWL has time-shifted settlement data to the effective reported date. This is because its reporting practice is inconsistent with the application of the SP methodology. We consider this a valid approach. ENWL was also the only DNO to historically report on RF data throughout DPCR4 so its close out is also on the basis of reconciliations up to and including RF.

A1.4 ENWL's restatement submission is on the basis of identifying abnormality in 2009-10, 2010-11 and 2011-12. As it reports to RF, 2012-13 data is not used in the reconciliation of data back into 2009-10 under Approach C. Application of the SP methodology results in losses of 4.94 per cent, 5xE of £43.2m and a PPL of £0.5m. This losses percentage is below the credibility thresholds. Therefore assessment based on the July framework results in a cap being applied at 5 per cent below the fully-reconciled losses in the normal period. Application of the cap increases the losses to 5.00 per cent and reduces the 5xE and PPL by £4.1m.

Northern Powergrid (NPg)

A1.5 The two NPg licensees have used reported data in their restatement applications. Both NPgN and NPgY identify abnormality in 2009-10 using the statistical test, while NPgN also identifies 2011-12 to be abnormal. NPg has provided additional evidence to support abnormality for all post 2009-10 years and has applied for restatement on this basis. The evidence for both licensees has been published on our website and includes the following.

- The SF adjustment and SF normalisation mapping applied to years beyond 2008-09 and 2009-10.
- The pattern of losses over time showing a change towards the end of DPCR4.

- The statistical test applied on a calendar year basis.
- Evidence provided by suppliers that GVC continued beyond 2009-10.
- Explanation of the enduring effects of GVC on settlement data.

A1.6 We do not analyse this evidence here but, in Chapter 2, we are inviting views on the appropriateness of allowing further evidence to be used for post 2009-10 years should these years not be found to be abnormal under the prescribed statistical test. We also welcome views on the strength of the evidence provided by NPg, along with any other appropriate evidence, to help inform our assessment should it be necessary.

A1.7 On the basis of NPg's application:

- NPgN's losses would be 4.85 per cent. This losses percentage is below the credibility thresholds from the July framework which would result in a cap being applied at 5 per cent below the target losses. Application of the cap would increase the losses to 4.94 per cent with a resultant 5xE of £11.7m and PPL of -£1.4m
- NPgY losses would be 5.00 per cent. This losses percentage is below the credibility thresholds from the July framework which would result in a cap being applied at 5 per cent below the fully-reconciled losses in the normal period. Application of the cap would increases the losses to 5.59 per cent with a resultant 5xE of £20.5m and PPL of -£27.7m.

A1.8 The July framework did not expressly invite additional evidence to be used to support abnormality in post 2009-10 years. Therefore, assessed against that framework:

- NPgN would normalise 2009-10 and 2011-12 data, resulting in losses of 5.12 per cent, 5xE of £3.5m and PPL of -£9.5m. This losses percentage is above the credibility thresholds based on the July framework so no cap would be applied
- NPgY would normalise 2009-10 only, resulting in losses of 5.55 per cent. This losses percentage is below the credibility thresholds which would result in a cap being applied at 5 per cent below the fully-reconciled losses in the normal period. Application of the cap would increase losses to 5.59 per cent with a resultant 5xE of £20.5m and PPL of -£27.7m. That is, for NPgY, based on the July framework, the cap applied would be the same regardless of the abnormality identified in post 2009-10 years.

Western Power Distribution (WPD)

A1.9 In line with our decision in the July 2013 document WPD has removed the CT adjustments from its data for the EMID and WMID licence areas.

A1.10 WPD has applied for restatement for three of its four licensees (EMID, WMID and SWEST). SWALES has not applied for restatement. Consistent with past applications, WPD has applied for restatement on the basis of settlement data time-shifted to represent the date that it would have been received on each billing day. This effectively removes provisions and other estimates and is consistent with paragraphs 2.15 and 3.30 of our July 2013 document. As part of WPD's restatement submission, we have published its justification for this approach.

A1.11 For SWEST, 2009-10 and 2011-12 are identified as abnormal. Application of the SP methodology would result in losses of 6.35 per cent, 5xE of £25.6m and a PPL of -£1.5m. This losses percentage is above the credibility thresholds based on the July framework so no cap is applied.

A1.12 2009-10 is not identified as abnormal in the statistical test for either EMID or WMID. In our July decision we set out that we would consider additional evidence where the abnormality for 2009-10 was not identified in the test.

A1.13 For these two licensees, WPD has provided additional evidence to support abnormality in 2009-10 and in 2010-11. This evidence, published alongside this consultation, includes:

- evidence from suppliers of the levels of GVC affecting the latter years of DPCR4

- evidence that levels of reconciliations in the RF and DF runs became increasingly negative in 2005-06 and onwards in comparison with earlier periods

- evidence that maximum demand has reduced in all of its licence areas over the DPCR4 period.

A1.14 We also stated that if a DNO fails the statistical test for abnormality for 2009-10, but it provides some evidence that it has been affected by abnormal levels of data correction activity and its un-restated losses for 2009-10 were above the reciprocal cap then it may be permitted to apply for restatement. We would like to clarify that the reciprocal cap should be compared with fully-reconciled un-restated losses as this data would be used to close out the mechanism in the absence of restatement.

A1.15 In Chapter 2 we are seeking views on the use of this reciprocal cap in order to highlight where the volatility of settlements data exposes DNOs to potentially unreasonable losses outcomes. We note that for WMID, the fully-reconciled losses for 2009-10 are above the reciprocal cap, while the EMID losses are not. On this basis, the vanilla assessment presented in Chapter 3 is based on WMID normalising 2009-10.

A1.16 As stated above we are seeking views on whether or not we should be considering additional evidence for post 2009-10 years that were not found to be abnormal under the statistical test. We would also welcome views on the evidence provided by WPD and would encourage other stakeholders to provide additional evidence that may help inform our assessment.

A1.17 We present the outcomes for WPD below under various scenarios, depending on whether or not 2009-10 and/or 2010-11 are considered abnormal and hence normalised in the restatement process. Under none of the scenarios below does each of the DNOs breach the credibility thresholds so would remain uncapped in the assessment against the July 2013 framework.

Table 5 – Restatement scenarios for EMID and WMID

	Years normalised	Losses (%)	5xE (£m)	PPL (£m)
WMID	None	5.64%	-47.5	-23.7
	2009-10	5.57%	-42.6	-18.8
	2009-10; 2010-11	5.31%	-24.4	-0.6
EMID	None	6.00%	-24.3	-87.3
	2009-10	5.84%	-11.6	-74.6
	2009-10; 2010-11	5.78%	-7.1	-70.1

A1.18 WPD has also suggested that the stipulated normal period is not appropriate for EMID. As stated above, stakeholders are invited to provide evidence where they consider that the common normal period is not appropriate for a particular licensee, and a different normal period may be appropriate.

A1.19 We note that the normal period proposed by EMID includes 2005-06. For the data used by EMID under restatement Approach C the losses in 2005-06 were 3.4 per cent. If the reconciliations in that year brought the figure to that level this suggests they were unusually low (compared with 5.7 per cent and 6.1 per cent losses in the stipulated normal period, and a DPCR4 target of 5.7 per cent). Assuming abnormality in 2009-10, our modelling suggests that the alternative normal period would improve EMID's losses outcome to the extent it is capped (assuming capping based on the existing stipulated normal period). This represents an improvement to the DNO of around £34m relative to normalising 2009-10 based on the stipulated normal period.

A1.20 We ask a question in Chapter 2 on whether any DNO should be able to use a different normal period based on strong evidence of abnormality in 2006-07 and 2007-08.

UK Power Networks (UKPN)

Data issues

A1.21 In its data submission, UKPN addressed a number of issues flowing from the data audit, detailed below.

The 10 GWh threshold for reconciling losses

A1.22 In our July 2013 document we specified, in relation to the outcome of the 2009-10 data audit, that we do not consider it reasonable to expect DNOs to fully reconcile their losses data to data derived from settlement. We considered a threshold of ±10 GWh for differences in losses (between DNOs' data and data derived from settlement) to be appropriate, with any differences larger than ±10

GWh to be removed. Discussion with industry highlighted this figure as representing a proportionate approach when comparing the cost of further investigations with the value of the incentive scheme.

A1.23 UKPN's submissions for years prior to 2009-10 followed this rationale and reduced differences between DNO's data and settlement data to 10 GWh, in a number of cases considerably benefitting the DNO. In our view for years prior to 2009-10 where there has not been a forensic audit, large adjustments against the interests of consumers are not warranted. UKPN has subsequently updated its data to comply with this. We have noted that the DNO can include a reasonable estimate for IDNO errors.

Data Management Units (DMU)

A1.24 In our July 2013 document we concluded that UKPN could include its data management units allocated over the years to which the error relates such that the close out calculation should only reflect electricity that actually flowed in 2009-10. However, we acknowledged that units that relate to 2009-10 may be found in years post-DPCR4. We stated that we would consider allowing UKPN to include units found in post-DPCR4 years that relate to energy flowing in 2009-10 where UKPN provides satisfactory evidence to justify such figures.

A1.25 In response to the July 2013 document, UKPN submitted data in relation to DMUs that relate back to the DPCR4 period. Following advice from our independent auditors, we are now satisfied with UKPN's proposed treatment, outlined below and reflected in its data submission. A short description of each category follows.

A1.26 *Reprofiling of units reported in DPCR4* – UKPN has reprofiled the units found in DPCR4 on the basis of the settlement periods to which they relate. This has resulted in 86 per cent of units previously reported in 2009-10 now being reprofiled into other periods including a significant proportion into DPCR3 years.

A1.27 *Units identified by Revenue Protection* – UKPN has analysed cases identified since April 2010 until June 2013 and reprofiled these units to the settlement periods to which they relate.

A1.28 *Projection of Revenue Protection units over the remaining DPCR5 period* – Using the detail of historical cases covering 2009-10 to 2012-13, UKPN has assessed the level of theft identified and the period to which the thefts relate. This assessment reflects cases yet to be uncovered but related to the DPCR4 period. Extrapolation has been restricted to the end of DPCR5 – hence including 18 months' worth of units yet to be found. UKPN's original estimate was based upon a straight average. We expressed concern that the straight average approach is likely to be generous given the declining nature of the cases found. UKPN has subsequently resubmitted its data with these units forecast in a more conservative manner.

A1.29 *Units identified as being used by energised customers but with a de-energised status* – This represents the value of units found by UKPN's programme of inspection of customers whose settlement status is de-energised. The calculation is based upon the energy calculated as having been consumed by the customer where the site is found to be energised. The calculation assesses the energy over the period from when the site was recorded as de-energised to when it was deemed to be energised by the supplier with reference to either its current consumption for a half-hourly metering site or the average consumption for the relevant profile class for a non-half-hourly metering site. Since it cannot be ascertained whether that site was ever physically de-energised (or if it was, at which point in time it was re-energised), UKPN has used an assumption that, on average, sites were energised for 50 per cent of the period. UKPN considered this to be a prudent approach owing to the time taken by suppliers to change the status once UKPN has identified the incorrect status (from analysis of records 12 months ago, it has taken suppliers approximately an average of 4-6 months to change a customer's status).

A1.30 *Units forecast to be found in the remainder of DPCR5 for energised customers with a de-energised status* – similar to the approach taken for theft, UKPN had also estimated the energy omitted from DPCR4 from future site visits of sites recorded as de-energised. We were concerned that to include forecasts of energised customers with a de-energised status has the potential to remove the incentive to find these units at all. In response, UKPN has excluded these forecast units.

A1.31 *Units not in settlements for individual investigation of larger sites* - This adjustment reflects errors identified from consumption patterns where Current Transformers (CTs) may have failed or the details are incorrect within settlements leading to an under-recording of units consumed. No inclusion has been made of estimated future cases which could be found over the remainder of DPCR5.

Restatement submission

A1.32 In contrast to the restatement process for 2012, UKPN has applied for restatement for LPN and SPN, in addition to EPN.

A1.33 UKPN has applied for restatement by removing provisions and other non-settlement units before conducting the abnormality test and applying the restatement methodology. We consider that this approach is consistent with paragraphs 2.15 and 3.30 of our July 2013 document and brings UKPN more in line with other DNOs that have needed to make changes to reported data for the SP methodology to be correctly applied. UKPN has provided further explanation for this approach in the covering letter for its submission. We also note that the alternative approach (of including non-settlement units) does not affect the outcome of the restatement under the July framework, as all three licensees are capped under both approaches.

A1.34 For each UKPN licensee, the abnormality test identifies 2009-10 and all post-2009-10 years to be abnormal. For each licensee, application of the SP methodology results in restated losses less than 5 per cent below the normal period losses so that capping would be applied in accordance with the July framework:

- For EPN the DNO's submission results in losses of 5.04 per cent which would be capped at 5.57 per cent. This capping would decrease the 5xE and PPL values by £53.6m.

- For LPN the DNO's submission results in losses of 5.10 per cent which would be capped at 5.53 per cent. This capping would decrease the 5xE and PPL values by £36.7m.

- For SPN the DNO's submission results in losses of 5.78 per cent which would be capped at 6.14 per cent. This capping would decrease the 5xE and PPL values by £22.9m.

Scottish Power Energy Networks (SP)

A1.35 Due to its reporting methodology, SP is the only DNO to have applied for restatement starting with fully-reconciled data. On this basis, both licensees identify abnormality for 2009-10 (as it is applying on a fully-reconciled basis, abnormality in post 2009-10 years is inconsequential to the SP position).

A1.36 Application of the SP methodology results in losses of 5.96 per cent, 5xE of -£32.6m and a PPL of £12.6m for SPD. For SPMW the equivalent figures are: 6.16 per cent, -£34.4m and £4.9m respectively. For both licensees, these losses percentages are above the credibility thresholds based on the July framework so a cap would not be applied to either licensee.

Scottish & Southern Energy (SSE)

A1.37 The two SSE licensees have not applied for restatement. The data audit resulted in no changes to its data, so the close out figures for SSE are the same as in the November 2012 consultation.

Appendix 2 – Impact Assessment

A2.1 Under section 5A of the Utilities Act 2000, subject to certain exceptions, we are required to carry out an impact assessment where a proposal is "important" within the meaning of that section.

A2.2 We consider that this consultation on the close out value of the DPCR4 losses incentive mechanism falls within the definition of what is important under the Act. We have therefore undertaken this Impact Assessment upon which we are now consulting in accordance with the provisions of s5A(8) of the Utilities Act.

A2.3 This appendix considers the costs, benefits and potential impact of the close out process, based on DNOs' submissions and our assessment against the framework set out in our July 2013 document. The data used to compile this analysis is published as Appendix 3 alongside this consultation.

Key objectives and summary

A2.4 The purpose of the distribution losses incentive mechanism is to incentivise DNOs to reduce losses on their distribution networks.

A2.5 We consider that sufficient evidence exists that abnormal levels of settlement data corrections have occurred in some distribution areas during 2009-10, the most important year in closing out the DPCR4 mechanism.

A2.6 We consider some restatement of data is necessary to give DNOs the opportunity to restore allowed revenue positions to the proper level. We would therefore allow restatement applications (in certain circumstances) and do not consider this to be detrimental to the interests of consumers.

A2.7 As the close out is backward-looking, it seeks to ensure that the rewards paid over DPCR4 reflect, as far as practicable, the performance of DNOs over the DPCR4 period. It takes into account the basis upon which the DPCR4 targets were set, and represents as close as practicable the energy that flowed during the price control period. We have also considered the fairness of the close out process and the need to avoid perverse outcomes.

A2.8 This impact assessment considers the aggregate values of restating losses levels in 2009-10 for closing out the mechanism. In November 2012 we consulted on four approaches to restatement and we selected Approach C[28] in our July 2013 document. The impacts presented are based on our assessment of the restatement applications made in response to the July 2013 document. The impact assessment also includes a consideration of the close out value for those DNOs not applying for restatement.

[28] See Glossary.

Assessment

A2.9 Our July 2013 document set our approach to permitting justified restatement requests under Approach C. The impacts presented show the DNOs' submissions in response to the July 2013 document for restatement ('DNO submission') against our assessment based on the framework in the July 2013 decision ('Vanilla' assessment).

A2.10 We also present the outcomes including an assessment against the July framework based on accepting abnormality where DNOs have not passed the statistical test for certain years but have provided other evidence for experiencing abnormality in these years. These assessments relate to EMID for 2009-10 ('09-10 abnormal' assessment), and to NPgN, NPgY, WMID and EMID for post 2009-10 years ('post 09-10 abnormal' assessment).The position in our November 2012 consultation ('Nov-12') and the un-restated position are also presented for comparative purposes.

A2.11 The assessment of the restatement submissions is subject to consultation. A more comprehensive set of outcomes is at Appendix 3.

A2.12 The calculated PPL terms for these options result in the following aggregate position for DNOs.

Table 6 – Aggregate PPL terms for DNOs

	Only DNOs applying for restatement	**All DNOs**
Nov-12	-£2.9m	£59.1m
Un-restated	-£630.8m	-£569.6m
DNO submission	£45.9m	£107.2m
Vanilla assessment	-£157.3m	-£96.1m
09-10 abnormal assessment	-£144.6m	-£83.4m
Post 09-10 abnormal assessment	-£113.8m	-£52.5m

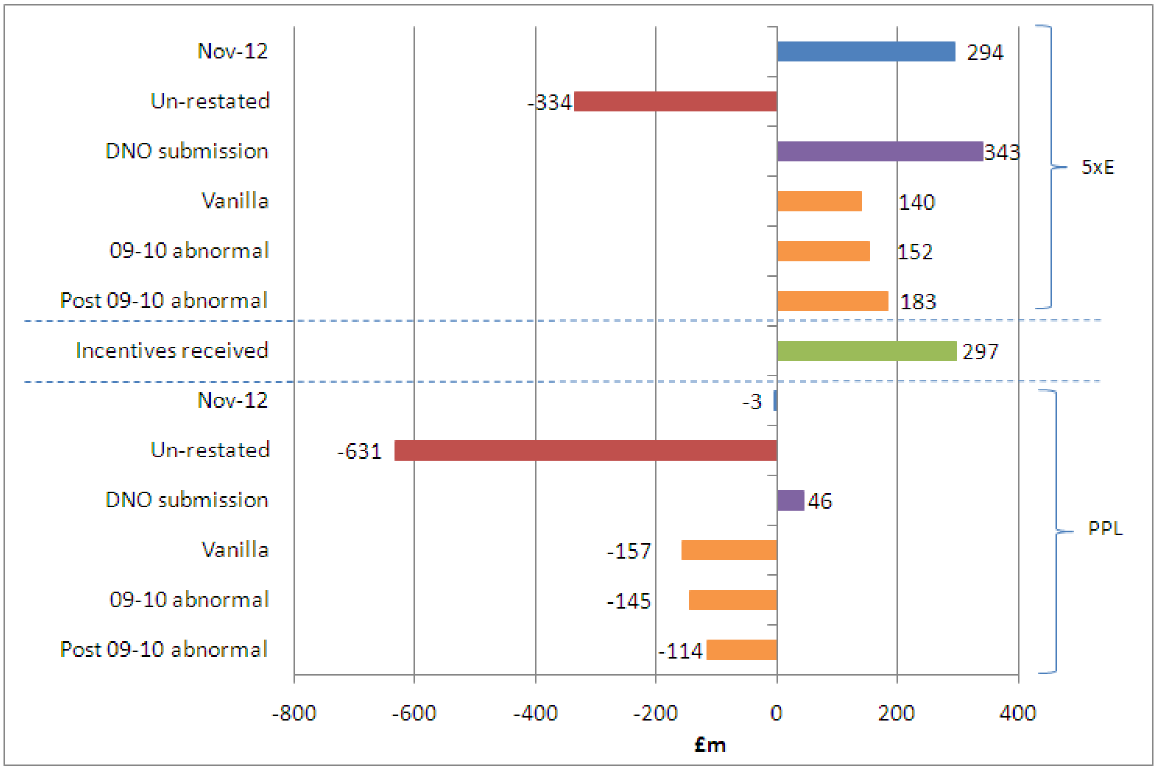
A2.13 The DNO submissions would result in a positive PPL for the DNOs, whilst our assessment against the July 2013 framework would result in the DNOs returning money to consumers.

A2.14 The next section presents a series of charts and tables to summarise the impact of the total value of the incentive (5xE) and the close out values (PPL) for each DNO. The PPL term is equal to 5xE less the incentives already received during DPCR4. The following sections then consider the impact of our approach in more detail. In the charts that follow, the three assessment options are presented as orange bars.

Summary of impact

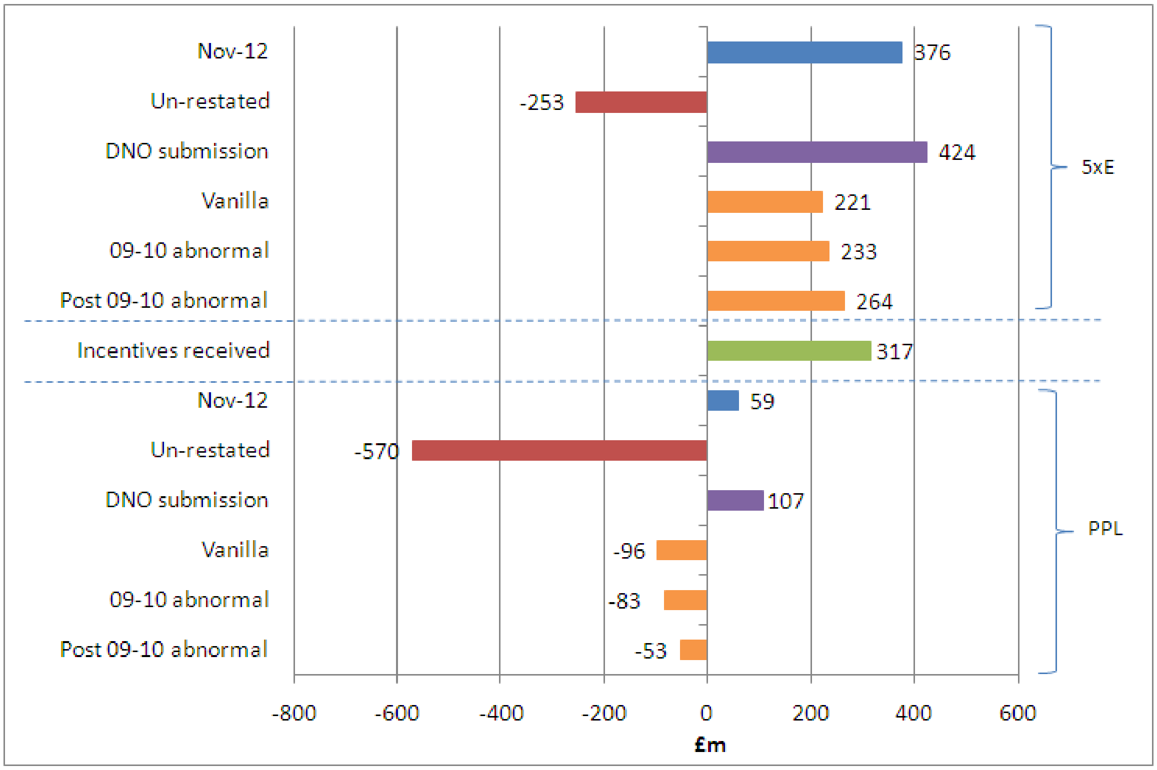
Impact on DNOs in aggregate

Figure 1 - DPCR4 losses outcomes for 11 DNOs applying for restatement



A2.15 For restatement DNOs, the three assessment options represent outcomes where the aggregate value of the incentive is closest to zero of the options presented.

Figure 2 - DPCR4 losses outcomes for all DNOs



A2.16 Under our assessment options, on aggregate DNOs would be returning between £53m and £96m.

Table 7 – PPL terms for DNO groups

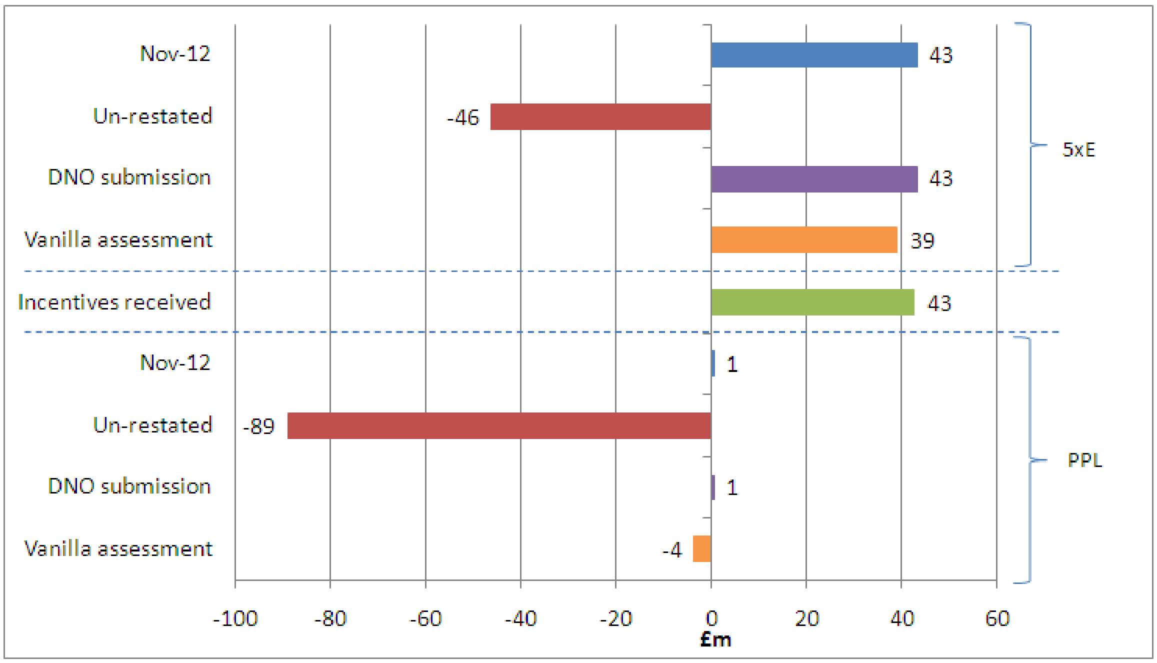
£m	Nov-12	Un-restated	DNO submission	Assessment		
				Vanilla	09-10 abnormal	Post 09-10 abnormal
ENWL	1	-89	1	-4		
NPg	-6	-109	13	-37		-29
WPD	-43	-132	-79	-114	-102	-79
UKPN	23	-169	87	-27		
SP	17	-139	18	18		
SSE	68	68	68	68		

A2.17 Under our assessment outcomes WPD would return the most money, while the highest PPL is for SSE which has not applied for restatement.

Impacts on individual DNOs

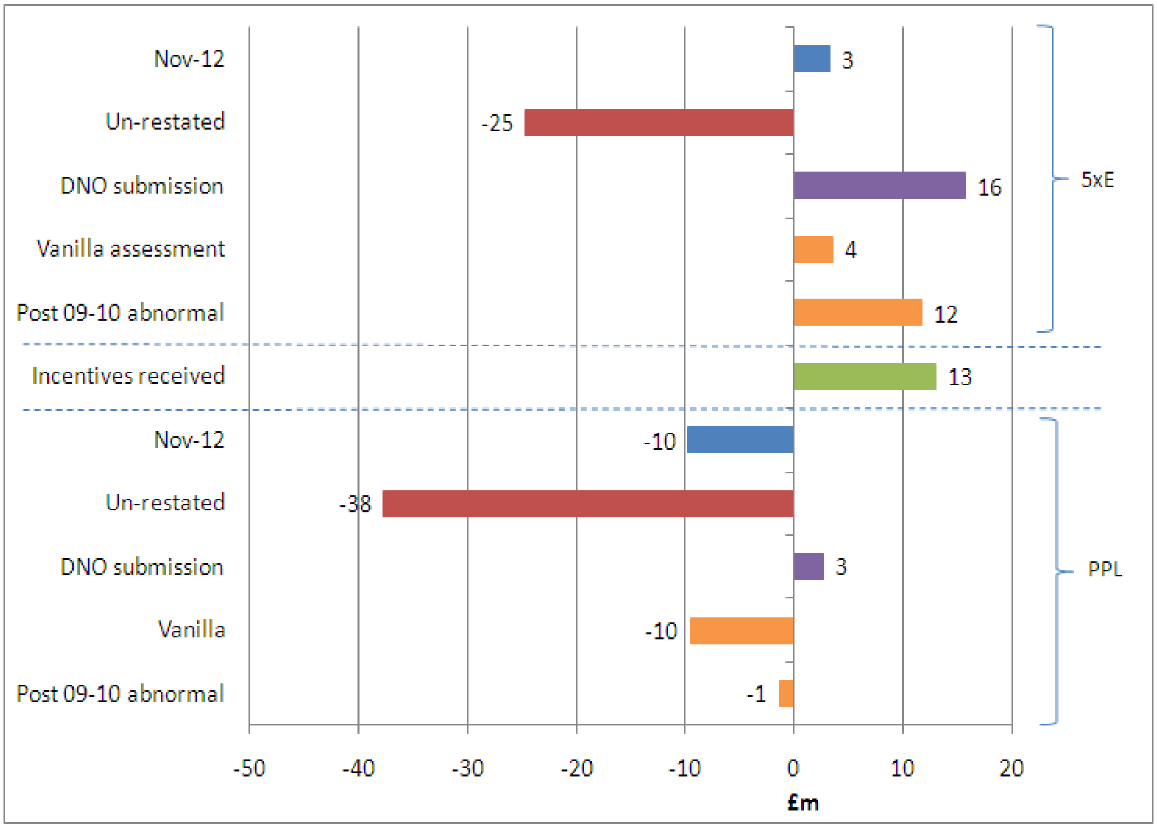
A2.18 The following charts display the overall outcomes under the DPCR4 losses incentive mechanism for each DNO for each of the four scenarios. A more detailed assessment of the submissions in presented at Appendix 1.

Figure 3 - DPCR4 losses outcomes for ENWL



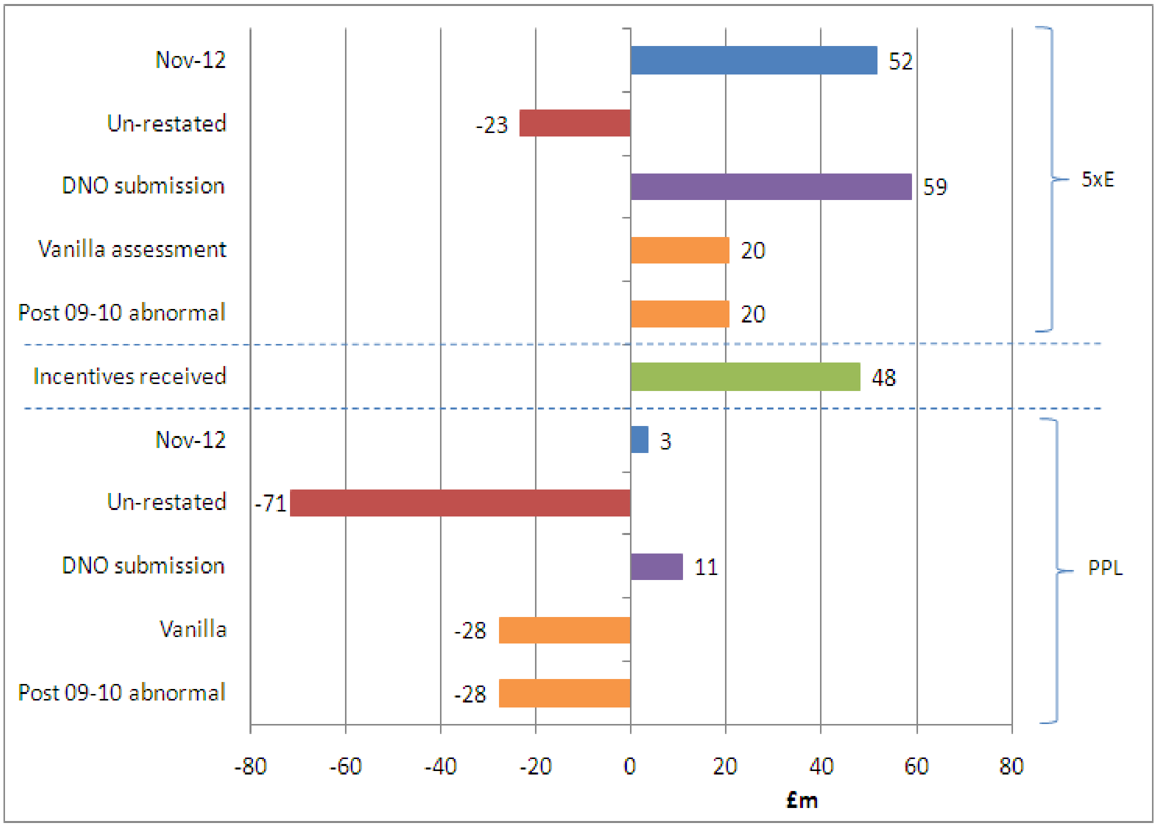
A2.19 Application of the credibility cap in our vanilla assessment would limit the overall rewards to ENWL by £4m relative to its restatement submission.

Figure 4 – DPCR4 losses outcomes for NPgN



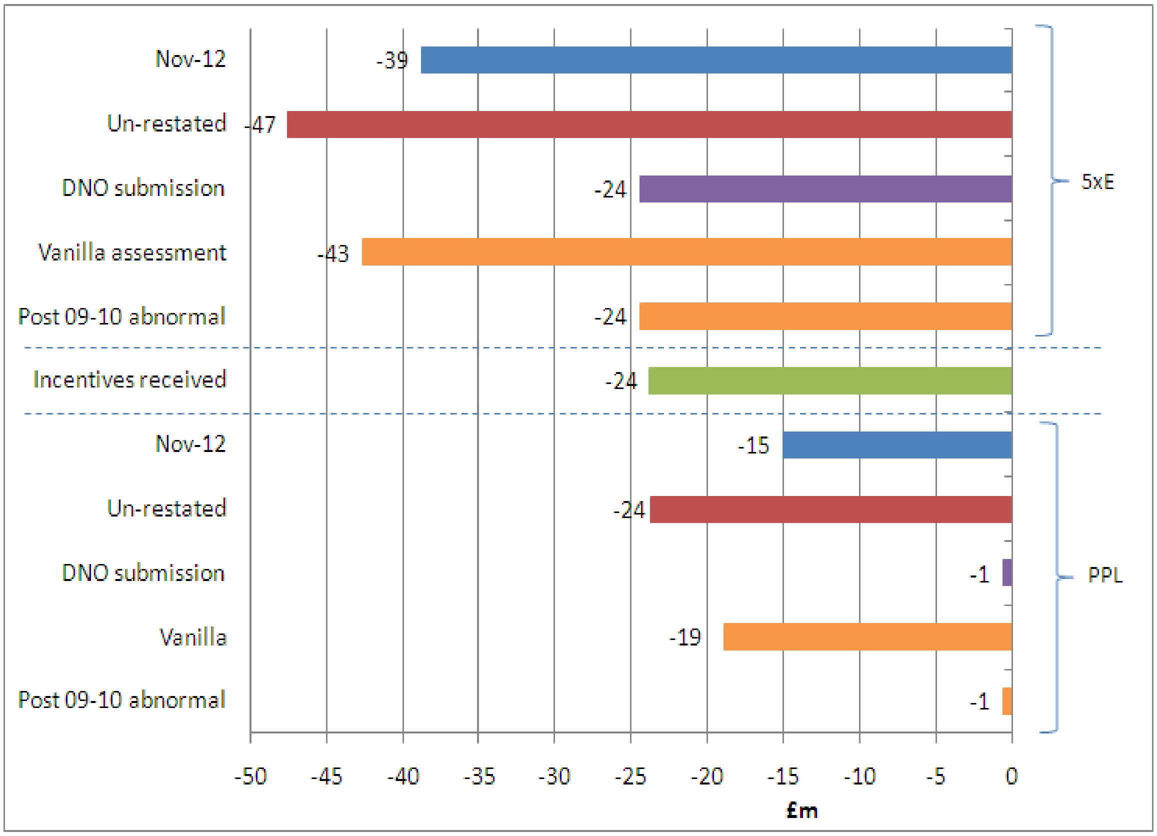
A2.20 For NPgN we present two assessment options. The vanilla assessment is based on abnormality being identified in 2009-10 and 2011-12, under which no cap would be applied. The alternative assessment is based on assuming all post 2009-10 years are abnormal; a cap would be applied to restatement under this approach. Both assessments would result in a reduction in overall rewards to the DNO against NPgN's submission.

Figure 5 – DPCR4 losses outcomes for NPgY



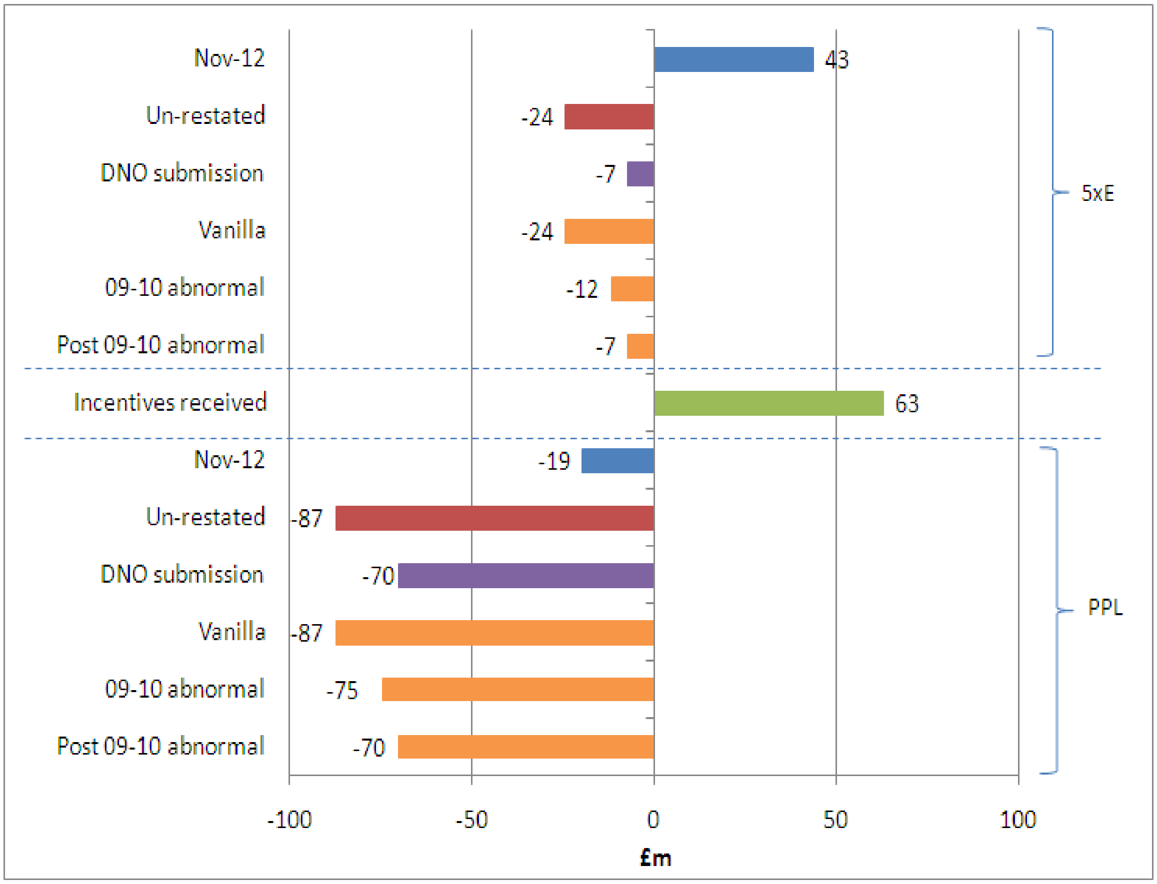
A2.21 For NPgY we present two assessment options. The vanilla assessment is based on abnormality being identified in 2009-10 only, under which a cap would be applied. The alternative assessment is based on assuming all post 2009-10 years are abnormal and the same cap would be applied to restatement under this approach. Both assessments would result in a reduction in overall rewards to the DNO against NPgY's submission.

Figure 6 – DPCR4 losses outcomes for WMID



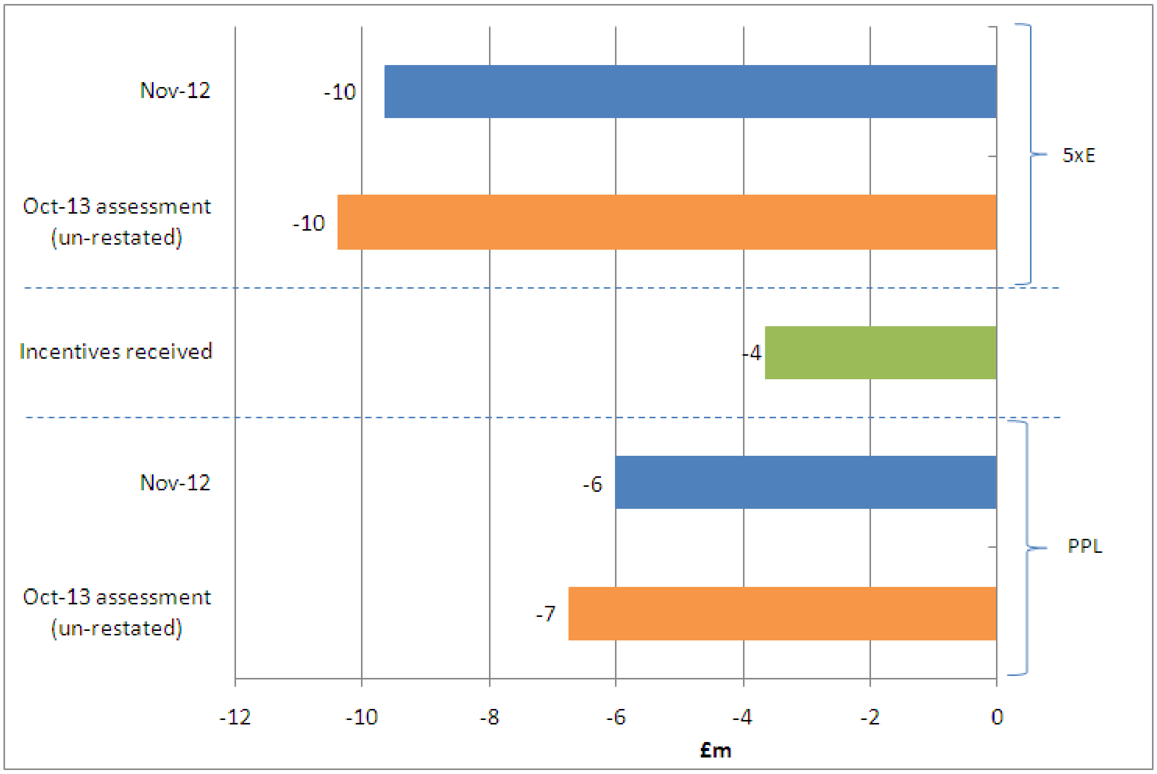
A2.22 For WMID we present two assessment options. The vanilla assessment is based on abnormality being identified in 2009-10 only, under which no cap would be applied. The alternative assessment is based on assuming both 2009-10 and 2011-12 are abnormal. Again no cap would be applied to restatement under this approach.

Figure 7 – DPCR4 losses outcomes for EMID



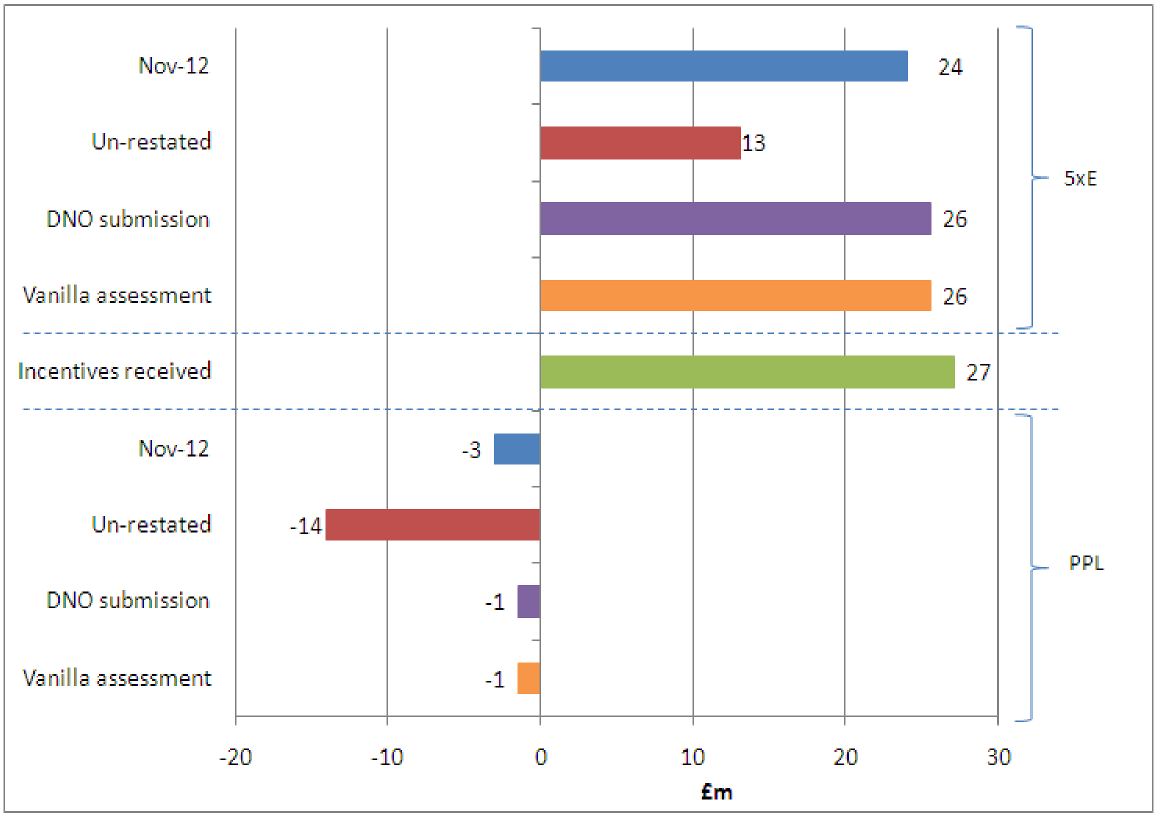
A2.23 For EMID we present three assessment options. The vanilla assessment is based on no abnormality being identified and therefore is the same as the un-restated position. The second assessment is based on abnormality in 2009-10 only, under which no cap would be applied. The third assessment is based on assuming both 2009-10 and 2011-12 are abnormal. Again no cap would be applied to restatement under this approach.

Figure 8 – DPCR4 losses outcomes for SWALES



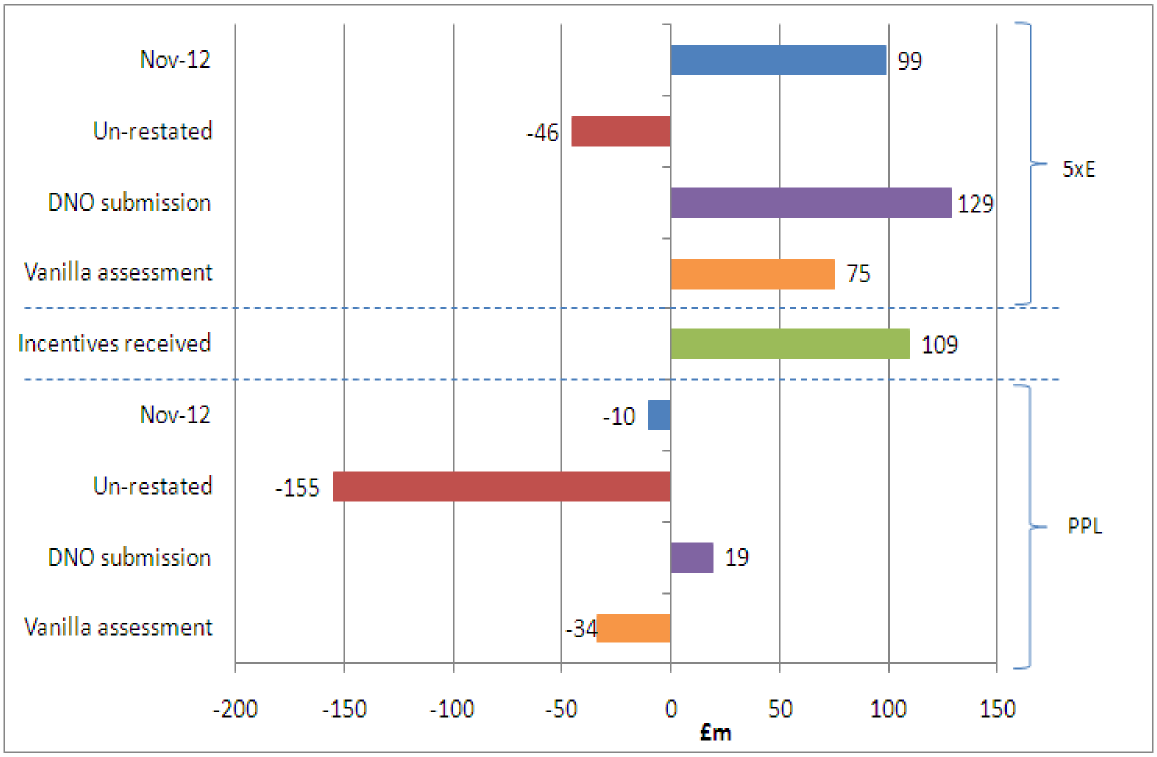
A2.24 SWALES did not apply for restatement. The minor differences in the outcomes since November 2012 relate to data changes following the audit process.

Figure 9 – DPCR4 losses outcomes for SWEST



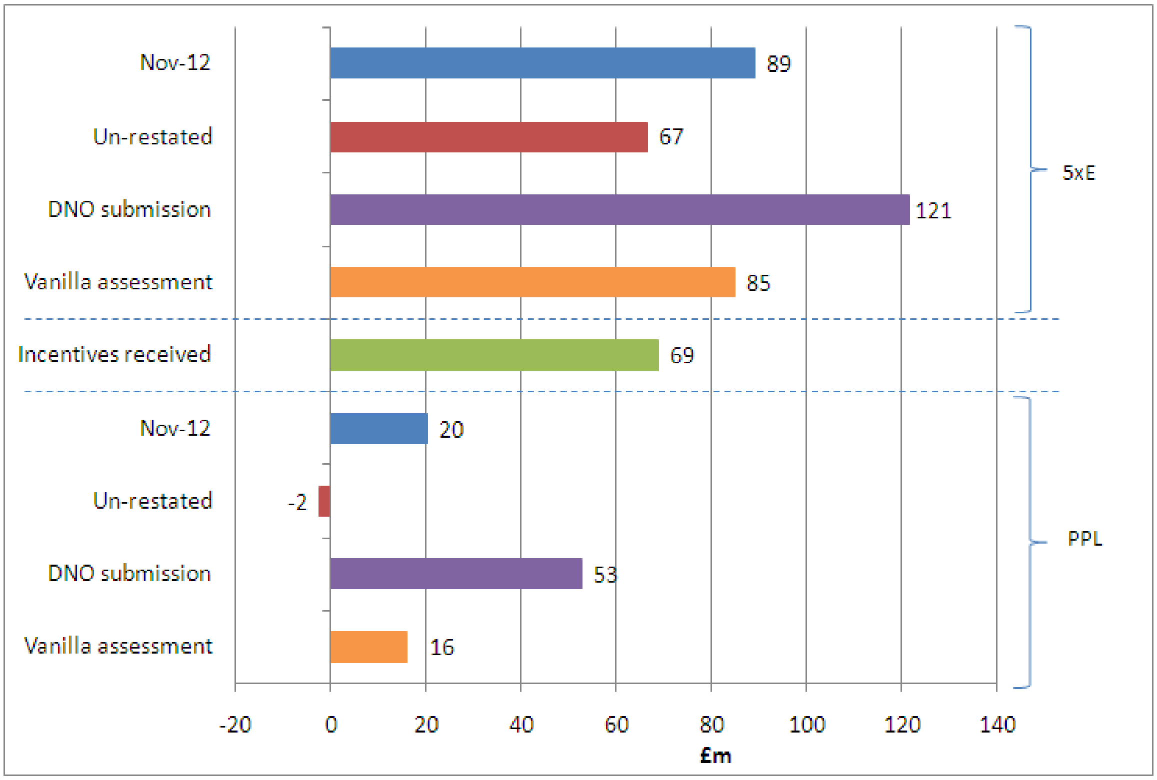
A2.25 Under our assessment, SWEST's restatement submission would be approved. This would result in the DNO returning £1m of the incentives it has already received.

Figure 10 – DPCR4 losses outcomes for EPN



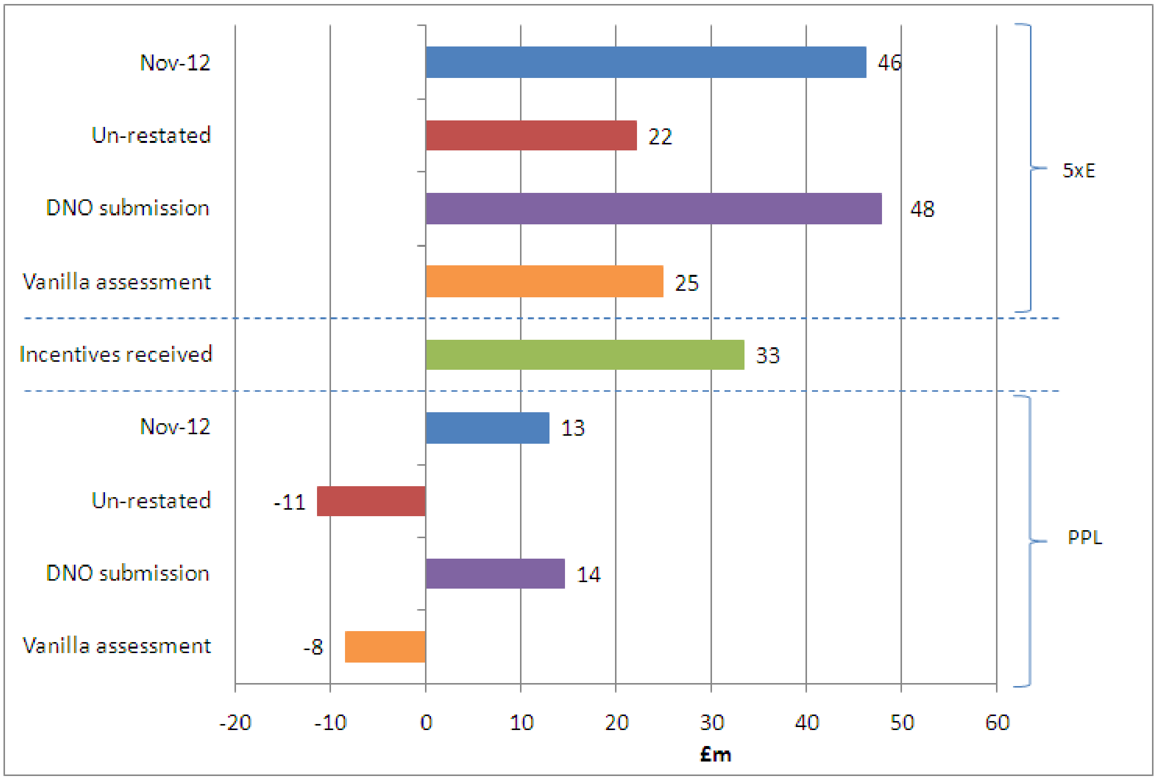
A2.26 Application of the credibility cap in our assessment would limit the overall rewards to EPN by £54m relative to its restatement submission.

Figure 11 – DPCR4 losses outcomes for LPN



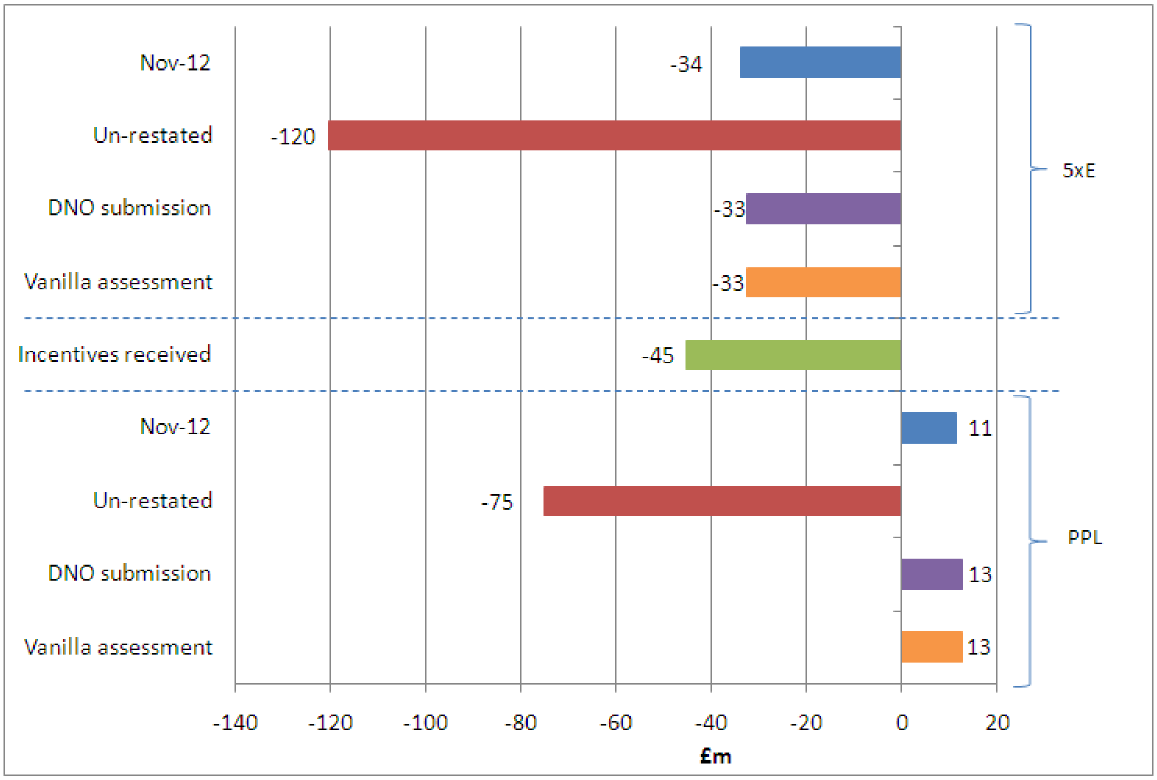
A2.27 Application of the credibility cap in our assessment would limit the overall rewards to LPN by £37m relative to its restatement submission.

Figure 12- DPCR4 losses outcomes for SPN



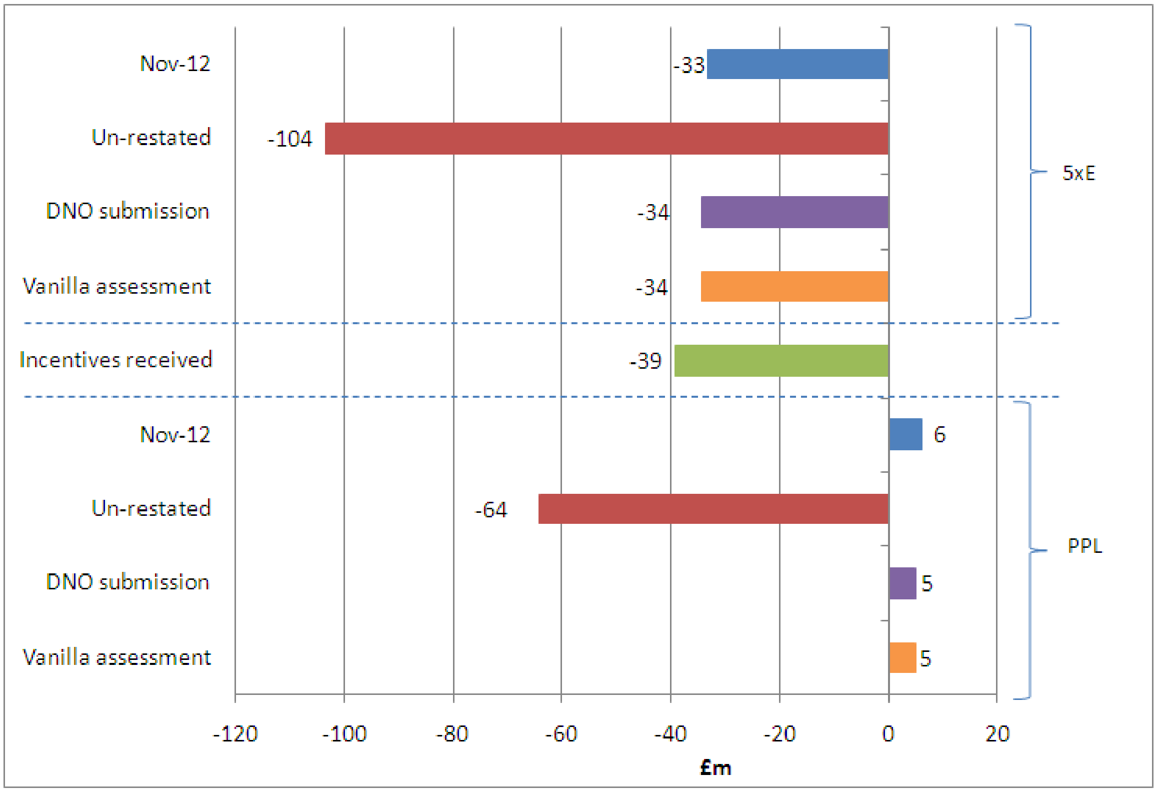
A2.28 Application of the credibility cap in our assessment would limit the overall rewards to SPN by £23m relative to its restatement submission.

Figure 13 – DPCR4 losses outcomes for SPD



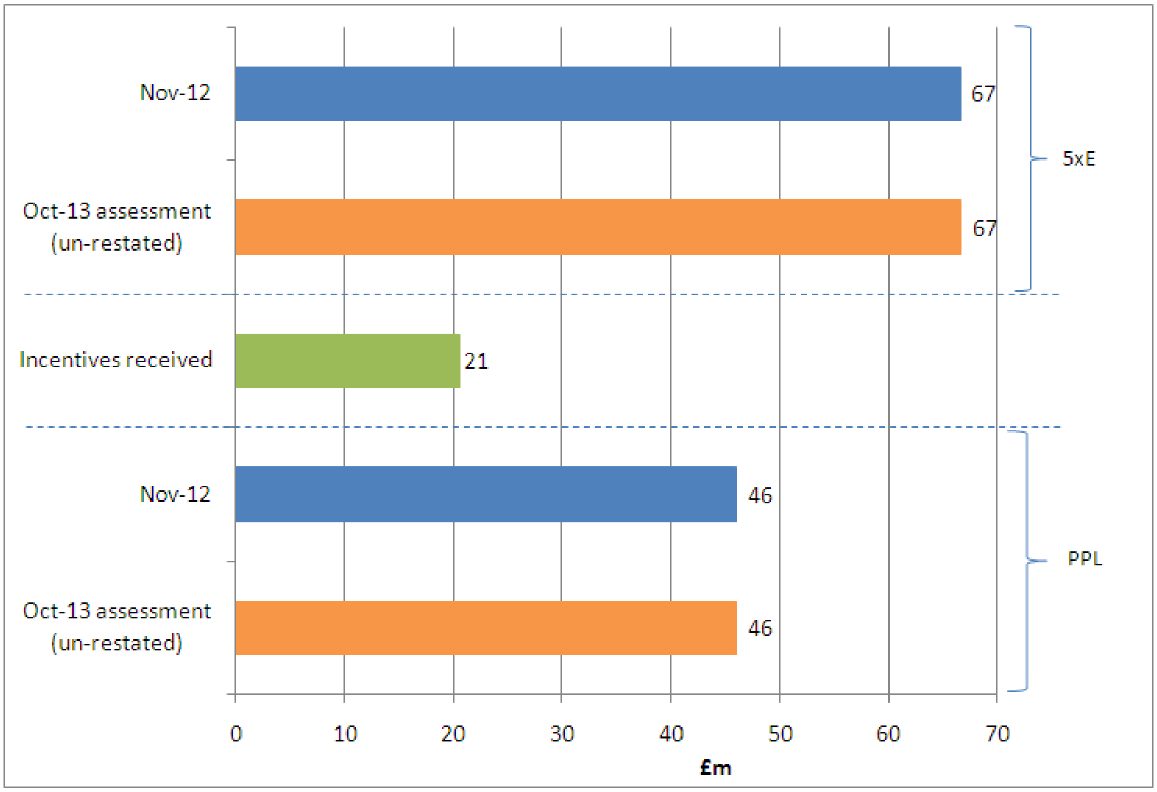
A2.29 Under our assessment, SPD's restatement submission would be approved. This would result in an overall penalty to the DNO of £33m over the DPCR4 period.

Figure 14 – DPCR4 losses outcomes for SPMW



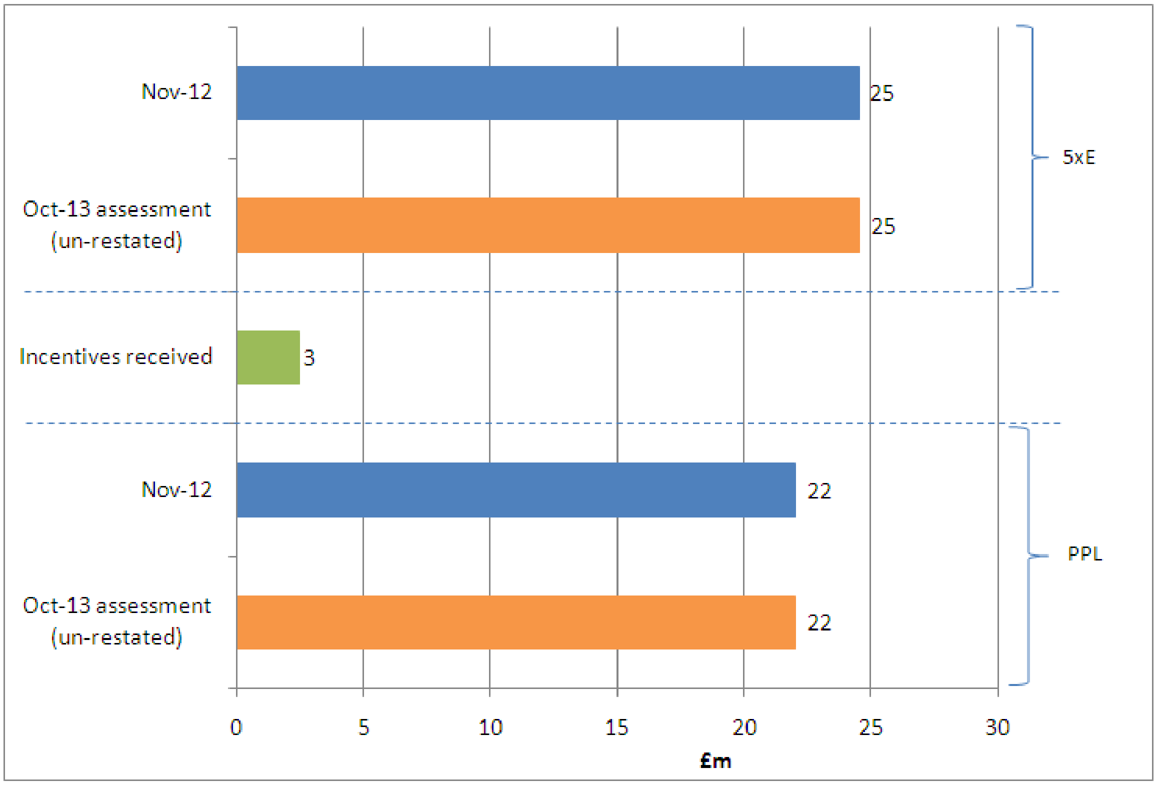
A2.30 Under our assessment, SPMW's restatement submission would be approved. This would result in an overall penalty to the DNO of £34m over the DPCR4 period.

Figure 15 – DPCR4 losses outcomes for SSES



A2.31 SSES did not apply for restatement and its outcomes are unchanged since the November 2012 consultation.

Figure 16 – DPCR4 losses outcomes for SSEH



A2.32 SSEH did not apply for restatement and its outcomes are unchanged since the November 2012 consultation.

Impact on consumers

A2.33 The principal benefit to consumers from improved losses performance is the reduced costs from energy lost in its distribution. All else being equal, the lower the losses, the lower the amount of energy for which consumers must pay.

A2.34 Under our assessment options DNOs overall would be returning money to consumers. DNOs overall would need to return between £53m and £96m. This negative overall figure masks the fact that some DNOs have some incentive left to recover through the PPL term. Customers in those DNO areas where the PPL value is positive are therefore more likely to incur additional costs through the recovery of the PPL values.

A2.35 Although restatement of losses improves the position of the DNOs relative to not restating, where there is sufficient evidence that abnormal levels of settlement data corrections have occurred, we consider allowing restatement is on balance in the interest of consumers. Furthermore, our assessment options would serve to limit rewards to DNOs by between £160m and £203m relative to accepting DNOs' submissions.

Impacts on competition

A2.36 DNOs do not compete directly with one another in the provision of electricity networks services.

A2.37 In making our decision, we are required to take into account our principal objective under s3A of the Electricity Act 1989 which, in summary, is to protect the interests of existing and future consumers in relation to electricity and to carry out our functions, where appropriate, by promoting effective competition in the generation, transmission, distribution or supply of electricity. In the context of this decision we are specifically required to carry out our functions in a manner that we consider best promotes efficiency and economy on the part of DNOs and the efficient use of electricity conveyed by distribution systems.

A2.38 Our decision may affect competition in the supply market. This is because the restatement approach will affect DNOs distribution use of system (DUoS) charges differently depending on their PPL terms. Depending on the market share of suppliers in different DNO areas, certain suppliers will face higher charges than others. In some cases this has the potential to affect a supplier’s position (for instance the dominant supplier for SSE compared with that for WPD).

A2.39 Market participants, suppliers in particular, rely on a certain level of stability and certainty to ensure they are able to effectively plan ahead and attract/maintain appropriate levels of investment. The decision that we take on the approach to restatement will inevitably alter the DNOs’ forecasted allowed revenue over a number of years. In the short term, this may have the effect of reducing certainty and if recovered immediately from suppliers could negatively impact competition. We are consulting on the period over which the PPL term should be recovered, which should help ensure that suppliers have sufficient warning of changes which should minimise the negative impact on competition.

Impacts on the environment (and sustainable development more generally)

A2.40 The distribution losses incentive mechanism was designed to incentivise the reduction of losses on the distribution network. This contributes to the achievement of carbon reduction and reduction of costs. In particular, the mechanism seeks to contribute to three of our sustainable development themes: reducing carbon emissions, promoting energy savings and ensuring a secure electricity supply. The main impact on sustainable development of this consultation is the extent to which the DNOs were incentivised in DPCR4 to invest in loss reduction activities, at a time when distribution losses are estimated to contribute around 1.5 per cent of GB greenhouse gas emissions.

A2.41 This consultation on closing out the DPCR4 mechanism is backward-looking, relating to energy that has already flowed in the system. Therefore the environmental impacts of that energy cannot be affected.

A2.42 Given the above, we do not consider there will be an impact on the environment.

Impacts on health and safety

A2.43 We do not consider there to be an impact on health and safety.

Post-implementation review

A2.44 Following the implementation of the close out, we will continue to monitor industry performance on losses. We are also developing a losses incentive mechanism for the next price control period (RIIO-ED1), which aims to avoid, to the extent practicable, reliance on settlement data for measuring DNOs' performance.

Conclusion

A2.45 The importance of reducing electrical losses has always been central to the purpose of the losses incentive mechanism. We continue to believe that allowing restatement, where justified, maintains regulatory certainty and is in the interests of consumers. We are seeking the views of stakeholders to this consultation, including on our assessment of the restatement submissions.

Appendix 3 – Components of PPL calculation

A3.1 Appendix 3 is available as an Excel ® spreadsheet published alongside this consultation. It contains the data and calculation steps necessary to reach a draft PPL under different scenarios for each DNO. It also presents the financial impact on the growth term under the different restatement scenarios for those DNOs applying for restatement.

Appendix 4 – Background

DPCR4 Distribution Losses Incentive mechanism

A4.1 We introduced the distribution losses incentive mechanism in successive price control periods to encourage DNOs to attain an efficient level of losses on their network.[29]

A4.2 Settlement data is made up of successive data updates. The RF (run final) and DF (dispute final) are respectively the penultimate and last reconciliation runs affecting any given period. RF is available 14 months after the energy originally flowed, while DF, if used, is available up to another 14 months after RF.

Data cleansing affecting losses performance

A4.3 Suppliers may conduct data cleansing activities to correct for errors and improve the accuracy of the settlement system. For example, a supplier may identify an unoccupied site for which it had been estimating electricity consumption for a number of years for the purposes of settlement. The supplier may then correct the consumption for the whole period of erroneously identified occupation in one updated (negative) reading that enters into settlement. If the supplier makes adjustments to correct historical data which can relate to a number of years, this places the full effect of the correction into the year during which that correction is made.

A4.4 During 2010 some DNOs noted high levels of data reconciliation corrections arising from abnormal levels of Gross Volume Corrections (GVCs)[30] and other data cleansing activity by suppliers. Changes to the governance of the settlement process, effective from March 2010, limited the use of GVC which may have prompted suppliers to increase their use of GVC in the run up to this change taking effect.

A4.5 It is worth noting that our efforts are focused on addressing **abnormal** levels of data cleansing, rather than any level of data cleansing, since data cleansing has been long used historically by suppliers to correct settlement data.[31] The use of fully-reconciled settlement data to close out the losses mechanism (with its problems when used for this purpose) formed part of the regulatory settlement for closing out DCPR4.[32]

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[29] In November 2012, we made a decision not to activate the DCPR5 losses incentive mechanism because of our concerns around the data used.
[30] GVC is used in the settlement process as a last resort method of correcting annualised meter data and estimated annual consumption levels where erroneous values have affected days whose final reconciliation has passed.
[31] i.e. Normal GVC was part of the price control settlement
[32] This was established in the DPCR5 Final Proposals: https://www.ofgem.gov.uk/ofgem-publications/45537/methodology-closing-out-dpcr4-losses.pdf. Fully-reconciled data means the reporting the data in relation to the period during which it flowed rather than the period that the data was received.

A4.6 Data cleansing tended to increase the recorded losses for affected DNOs for 2009-10, affecting the calculation of the close out position for DPCR4.

Normal period

A4.7 Identification of a 'normal period' is integral to the assessment of any abnormality and therefore the need to restate 2009-10 data.

A4.8 In our October 2011 consultation[33], we stated at 4.14: "... we refer to the assumption of a standard 'normal' period as part of SP's methodology, and whether the same period applies to all DNOs. We would expect a DNO to comment on this period, particularly if they consider that there is justification for a different normal period to be selected in their case. For the purposes of this exercise we would expect all DNOs to respond based on the same normal period as used by SP, even though one of the key points of the SP/Engage methodology is the ability to choose a 'normal' period based on observations of when adjustments started to impact on a DNOs data."

A4.9 Our 9 March 2012 decision letter[34] noted that we had expressed concern in the October 2011 consultation over the ability of DNOs to select their own normal period under the SP methodology. After consideration of the consultation responses, we set out certain safeguards which mitigated our concern to a large extent, such that we no longer considered this factor to weigh substantially against the SP methodology. The principles outlined in our 9 March 2012 letter are set out below.

- Applications could only apply for restatement to 2009-10 data.
- The normal period must occur within the DPCR4 period due to the unreliability of some data for prior years (particularly over short time periods).
- The normal period should cover a continuous period of at least two years and be longer in duration than the abnormal period.
- In addition to relatively stable reconciliation levels, reported losses performance during the normal period must be credible, eg the normal period should not include historically low, one-off, losses levels.
- The restatement must result in credible, technically feasible losses performance in 2009-10, that the licensee can justify would have been achievable.

A4.10 Our 14 March 2012 letter set out the statistical tests to be used along with the SP methodology, to identify abnormality affecting 2009-10 data and to find a normal period with more stable reconciliation levels. The normal period is then used to 'normalise' the data affected by an abnormality. DNOs were also able to use their

[33] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=607&refer=Networks/ElecDist/Policy/losses-incentive-mechanism
[34] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=660&refer=Networks/ElecDist/Policy/losses-incentive-mechanism

own approaches where they could provide evidence that their own approach was statistically robust.

A4.11 The 9 March 2012 letter also outlined that we may apply a cap based on the average losses performance for the first three years of DPCR4 in two circumstances:

- if a licensee can identify abnormal activity affecting 2009-10, but is unable to establish a normal period, or
- if a licensee's restatement application accords with the tests and principles set out but the restated performance is not credible.

A4.12 In response to our July 2012 data request[35], to apply the SP methodology, DNOs needed to identify two normal periods: one for normalising the SF position and the other for adjusting post-SF reconciliations.[36] DNOs were able to select two years from the first three years of DPCR4 for the SF normalisation, provided these years contained credible losses performance figures. DNOs used the statistical tests to identify a suitable normal period for adjusting post-SF reconciliations.

A4.13 Our 16 November 2012 consultation[37] presented our minded-to position on restatement of losses performance for both the 2009-10 annual incentive and for the final incentive value under the mechanism. In light of the responses to this consultation, we commissioned an independent critique of our approach to the statistical analysis, and revised the process to make it more robust and consistent across the DNOs.[38] In light of the helpful and constructive critiques to our approach received in response to the November consultation, we re-examined our approach and sought further independent advice. The critiques and our response cover the normal period and abnormality testing.

A4.14 Respondents to the November consultation raised concerns regarding the consistency of the level of rigour being applied to the justification of a suitable normal period by different DNOs, and the precise period to be used. They noted the importance of the selection of the normal period in calculating the final outcome of the restatement process, and argued that more rigour and consistency should be applied in assessing the normal period across the DNOs.

A4.15 In order to address these concerns we made some changes to our approach to both the selection of the normal period and the testing for abnormality. The July 2013 document consolidated and replaced any previous guidance on this issue. In this document, we are seeking views on whether any DNO should be able to use a different normal period based on strong evidence that 2006-07 and 2007-08 are inappropriate, as well as certain consequent issues.

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[35] https://www.ofgem.gov.uk/publications-and-updates/request-data-close-out-fourth-distribution-price-control-review-losses-incentive-mechanism
[36] SF is the Initial Settlement run in the electricity Balancing and Settlement Code settlements process.
[37] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=762&refer=Networks/ElecDist/Policy/losses-incentive-mechanism
[38] Appendix 2 of the July 2013 document offers further detail on the statistical analysis.

Appendix 5 – Consultation Response and Questions

A5.1 Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

A5.2 We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

A5.3 Responses should be received by 2 December 2013 and should be sent to:

Tim Aldridge
Smarter Grids & Governance: Distribution
9 Millbank, London, SW1P 3GE
020 7901 7350
distribution.losses@ofgem.gov.uk

A5.4 Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

A5.5 Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

A5.6 Next steps: Having considered the responses to this consultation, Ofgem intends to issue a direction on the final value of the PPL terms for each DNO in early 2014. Any questions on this document should, in the first instance, be directed to:

Tim Aldridge
Smarter Grids & Governance: Distribution
9 Millbank, London, SW1P 3GE
020 7901 7350
tim.aldridge@ofgem.gov.uk

CHAPTER: Two

Question 1: Do you have any views on whether any DNO should be able to use a different normal period based on strong evidence that 2006-07 and 2007-08 are inappropriate? What evidence should be considered?
Question 2: Do you have any views on the suitable normal period to be used should a DNO demonstrate, based on evidence, that the stipulated normal period is inappropriate for the restatement process?
Question 3: Do you have any views on the application of the proposed credibility cap in relation to the restatement applications for both the annual incentive and the close out?

Question 4: Do you have any views on the suitable normal period to be used in the credibility criteria should a DNO convince us that the stipulated normal period is inappropriate for the restatement process?
Question 5: Should we allow additional evidence for demonstrating abnormality for post 2009-10 years where a DNO fails the statistical test for these years (ie treat post 2009-10 years in the same way as 2009-10)?
Question 6: Do you consider that permitting restatement, based on exceeding the reciprocal cap thresholds with fully-reconciled un-restated data for 2009-10, is a fair and appropriate means of protecting consumers and DNOs from unreasonable outcomes in the close out process?
Question 7: Do you consider that 'reported-equivalent' data compared with the reciprocal cap should be applied to post-2009-10 years as evidence that contributes to a case for identifying abnormality in those years?

CHAPTER: Three

Question 1: Do you have any comments on the submissions from DNOs?
Question 2: Do you consider that DNOs have fulfilled the requirements set out in our July 2013 document?
Question 3: Do you have any comments on our assessment of the submissions?
Question 4: Do you have any comments on the steps we have taken to calculate values of the draft PPL terms?
Question 5: Do you agree that the cap has been applied equitably to relevant parties? Please provide evidence to support your argument.
Question 6: Do you consider that, more generally, the approach and calculations have been applied equitably in all circumstances?
Question 7: Do you have any views on the appropriate period for recovery of the PPL based on the draft PPL terms?
Question 8: Do you have any views on the way that indexation and the weighted-average cost of capital (WACC) should be applied when the close out values are recovered?

CHAPTER: Four

Question 1: Do you have any comment on our assessment of the restatement applications for the purpose of the 2009-10 annual incentive and the proposed changes to the growth term figures?
Question 2: Do you have any views on the way that indexation and the WACC should be applied when the changes to revenue as a result of changes to the growth term are recovered?

Appendix 6 – Glossary

A

Allowed Loss Percentage (ALP)

The target losses percentage determined for each DNO.

Approach C

A means of addressing the need to reflect the energy that actually flowed during DPCR4, and the effects of abnormal data cleansing. Appendix 3 of July 2013 document presents more detail on Approach C.

D

Data Management Units (DMU)

These are units distributed but not processed through settlement. Specifically used by UKPN in its losses close out data

Distribution Network Operator (DNO)

One of the licensed operators of the fourteen regional electricity distribution networks in Great Britain. The full list appears below.

Abbreviation	Full name
ENWL	Electricity North West Limited
NPgN	Northern Powergrid: Northeast
NPgY	Northern Powergrid: Yorkshire
WMID	Western Power Distribution: West Midlands
EMID	Western Power Distribution: East Midlands
SWALES	Western Power Distribution: South Wales
SWEST	Western Power Distribution: South West
EPN	UK Power Networks: Eastern Power Networks
LPN	UK Power Networks: London Power Networks
SPN	UK Power Networks: South East Power Networks
SPD	Scottish Power: Distribution
SPMW	Scottish Power: Manweb
SSES	Scottish & Southern Energy: Hydro
SSEH	Scottish & Southern Energy: Southern Electric Power Distribution

Distribution Price Control Review 4 (DPCR4)

DNOs operate under a price control regime, which is intended to ensure DNOs can, through efficient operation, earn a fair return after capital and operating costs while limiting costs passed onto customers. DPCR4 is the previous price control that commenced on 1 April 2005 and ended on 31 March 2010.

Distribution Price Control Review 5 (DPCR5)

DPCR5 is the existing price control that commenced on 1 April 2010 and will end on 31 March 2015.

G

Gross Volume Correction (GVC)

A facility within the balancing and settlements system to correct errors relating to meter advance periods in respect of which some settlement dates have already been subject to the final (RF) reconciliation run.

I

Independent Distribution Network Operator (IDNO)

Any Electricity Distributor in whose Electricity Distribution Licence the requirements of Section B of the standard conditions of that licence have no effect (whether in whole or in part).

N

Normal period

This is a period which is considered 'normal' which can be used to 'normalise' any abnormality, ie estimate the losses levels in the absence of this abnormality.

P

PPL

The amount left to recover or the residual losses incentive for each DNO for DPCR4.

S

Settlement Day (SD)

Term used in the BSC settlements process and is the period from 00:00 hours to 24:00 hours on each day.

Settlement Runs (SF, R1, R2, R3, RF and DF)

Settlement runs record the amount of electricity consumed for any given half-hour period. Subsequent runs replace estimated data with actual data as more meters are read.

Settlement Run Types	Approximate Period after Settlement Day
Initial Settlement – SF	17 Working Days
First Reconciliation – R1	2 Months
Second Reconciliation – R2	4 Months
Third Reconciliation – R3	7 Months
Final Reconciliation – RF	14 Months
Dispute Final - DF	Up to 28 months

SP methodology

The SP methodology was developed by Scottish Power and Engage Consulting as a means of recreating the reported data for 2009-10 in the absence of abnormal levels of data cleansing.

Supplier Volume Allocation (SVA)

SVA means the determination of quantities of Active Energy to be taken into account for the purposes of Settlement in respect of Supplier Balancing Mechanism Units.

Appendix 7 – Feedback Questionnaire

A7.1 Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

A7.2 Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk