

NORTHERN POWERGRID

**CLOSING OUT THE LOSSES INCENTIVE FOR THE FOURTH DISTRIBUTION
PRICE CONTROL REVIEW**

**APPLICATIONS FROM NORTHERN POWERGRID (NORTHEAST) LTD AND
NORTHERN POWERGRID (YORKSHIRE) plc TO RESTATE 2009-10 LOSSES FOR
THE PURPOSE OF DPCR4 CLOSE-OUT IN ACCORDANCE WITH THE DATA
REQUEST IN AN OFGEM DECISION DATED 12 JULY 2013**

02-08-2013

TABLE OF CONTENTS

INTRODUCTION 2

STATISTICAL TEST RESULTS 3

PATTERN OF LOSSES OVER TIME..... 11

EVIDENCE PROVIDED BY ENERGY SUPPLY BUSINESSES 15

EFFECT OF GVC CORRECTIONS ON SETTLEMENTS..... 17

RESTATEMENT OF LOSSES FOR THE CLOSE-OUT..... 21

RESTATEMENT OF LOSSES FOR THE ANNUAL INCENTIVE 22

CONCLUSIONS..... 23

INTRODUCTION

1. On 21 July 2013 Ofgem published a document titled *Decision on the process to follow for closing out the losses incentive mechanism for the fourth distribution price control (DPCR4)* (the Decision). The Decision included a data request addressed to all electricity distribution network operators (DNOs), and provided DNOs with the option to apply for restatement of 2009-10 losses for the purpose of closing out the losses incentive for the DPCR4 period.
2. Northern Powergrid (Northeast) Ltd and Northern Powergrid (Yorkshire) plc (respectively referred to as Northeast and Yorkshire in this document) formally apply to restate distribution losses in 2009-10. This document sets out the evidence that supports that application, and sets out results for the restatement which Northern Powergrid believes is justified based on the evidence.
3. The rest of this application:
 - a) First, sets out the results of the statistical test prescribed in the Decision.
 - b) second, sets out compelling evidence, in addition to the prescribed test, demonstrating that abnormal activity has affected 2009-10 and subsequent years; and
 - c) third, sets out the restatement values that result from our application.
4. Ofgem has set out a clear process for evaluating abnormality and undertaking restatement. Starting with reported data, this involves determining whether individual regulatory years have been subject to abnormal settlements activity, determining a

normal proxy for any such years, and then reconciling all data to meet the requirements of the DPCR5 *Final proposals*.

5. Ofgem's decision states 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.*'¹
6. Under the restatement methodology chosen by Ofgem, establishing whether or not the post-2009-10 years have been affected by abnormal corrections activity is also a determinant of the eventual outcome of the restatement. We therefore expect that, in addition to the statistical test results, Ofgem will wish to take into account evidence which is relevant to establishing whether or not the post-2009-10 years have been affected by abnormal data corrections activity. This is especially the case because abnormal activity in 2009-10 is likely to continue affecting settlements data for some time (even if there had been no further activity), and because changes in how abnormal activity is propagated through the dataset over time will make the prescribed statistical test less effective as a means of identifying whether abnormal activity has continued to affect the dataset. This document and the results of our restatement application have been prepared accordingly.

STATISTICAL TEST RESULTS

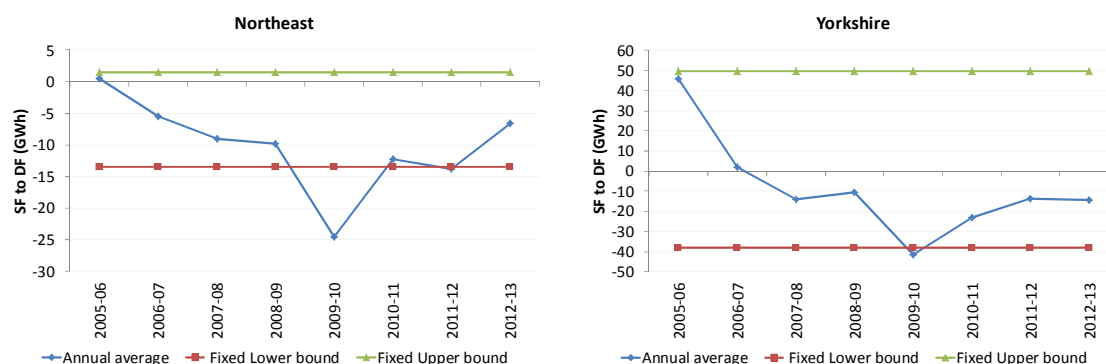
7. Ofgem has now decided that the only *statistical* test that can be used to provide a determinative conclusion that particular years have been affected by abnormal settlements activity is the statistical test set out in the template published with the Decision. This test is based on settlements reconciliations data for 2005-06 to 2012-13,

¹¹ Paragraph 3.21 of the Decision.

and an estimate of any abnormality present in settlements final (SF). This adjustment is known as the SF adjustment.

8. The SF adjustment is an integral part of SP/Engage method, and is adjusted for prior to statistical testing. Engage identified that the SF position during 2008-09 and 2009-10 would have been abnormal due to two factors:
 - a) the impact of the recession, which would have reduced actual energy consumed while SF was still being estimated on a pre-recession basis; and
 - b) abnormal settlement corrections activity depressing the forwards-looking estimated annual consumption (EAC) values used in the estimation of SF.
9. Since modelling both of these impacts would be extremely complex, the SP/Engage method estimates the degree to which SF losses differs from the normal levels of losses seen before the recession. By adding this difference to reconciliations received in 2009-10, the total impact on electrical losses of the change in supplier settlements corrections behaviour, along with any recessionary effect, can be estimated.
10. The results of the statistical test, with the SF adjustment to 2008-09 and 2009-10, are shown below.

Figure 1: Statistical test results applying the SF adjustment to 2008-09 and 2009-10



11. The test results show that reconciliations and SF activity in 2009-10 was abnormally negative. 2009-10 therefore qualifies for restatement in accordance with the Decision without the need to consider further evidence.

12. The Decision recognises that abnormality may still be demonstrated where the prescribed statistical test does not indicate abnormality in 2009-10. In such cases DNOs are invited to '*submit other evidence both quantitative and qualitative, to demonstrate that they have been affected by abnormal data corrections...*'² As the prescribed statistical test for abnormality is satisfied for both Northeast and Yorkshire there is no need for further evidence. This is not surprising, as in both Northeast and Yorkshire the reconciliations we received during 2009-10 led to significant reductions in reconciled units distributed during 2007-08, 2008-09 and 2009-10. What may however be surprising is the narrow margin by which abnormality is found in Yorkshire under the prescribed statistical test. Given the overwhelming scale of negative reconciliations received during 2009-10, at four times the level seen in the previous

² Paragraph 3.21 of the Decision.

year, the test appears to be drawing a bar for abnormality that is higher than would actually be appropriate.

13. In light of this, we expect that Ofgem will wish to take into account further evidence in evaluating whether the data for the post-2009-10 years is abnormal. Since Ofgem is open to receiving such evidence in relation to 2009-10, it should be equally open to taking it into consideration for the subsequent years. Moreover, the negative reconciliations were particularly apparent in reported data for 2009-10 as they related to settlements corrections suppliers were making to three years. Nothing in the Decision precludes Ofgem from taking such information into account.
14. In the subsequent years, abnormal activity continuing at the same level would be less apparent in reported data, partly because the activity in 2009-10 will continue to propagate into SF, and partly because suppliers have already had the opportunity to undertake some of the adjustments that their new behavioural standard is consistent with. For example, the significant number of negative reconciliations applied to 2007-08 and 2008-09 during the course of 2009-10 will mean that the reported level of negative reconciliations in 2010-11 is likely to be lower, simply by virtue of the fact some historical reconciled data had already been adjusted. But that is not to say that supplier behaviour reverted to its earlier standard. Indeed, there were still significant volumes of negative reconciliations affecting 2009-10 being undertaken in the subsequent years. It simply means that the data generating process will tend to mask continued abnormal activity when applying Ofgem's prescribed statistical test to reported data.
15. This means that additional evidence, beyond the prescribed statistical test, of continuing abnormal activity may well be *more* relevant for the subsequent years than for 2009-10,

since by definition the nature of the activity and settlements systems means that continuing abnormal activity is less likely to be identified by the statistical test applied to these years than is the case for abnormal activity in 2009-10.

16. Using only the prescribed statistical test, the data for 2010-11 with respect to Northeast and Yorkshire shows marginal failures of the prescribed statistical test if SF adjustment is only applied to 2008-09 and 2009-10, being close of the boundary of the confidence interval. As Ofgem recognises at paragraph 3.20 of the Decision, the test has some inevitable shortcomings. The test has low power because:

- a) there is a small number of data points available;
- b) there is evidence that abnormal supplier corrections activity started prior to 2008-09;³ and
- c) the pattern of reconciliations seen in 2005-06 was abnormally positive.

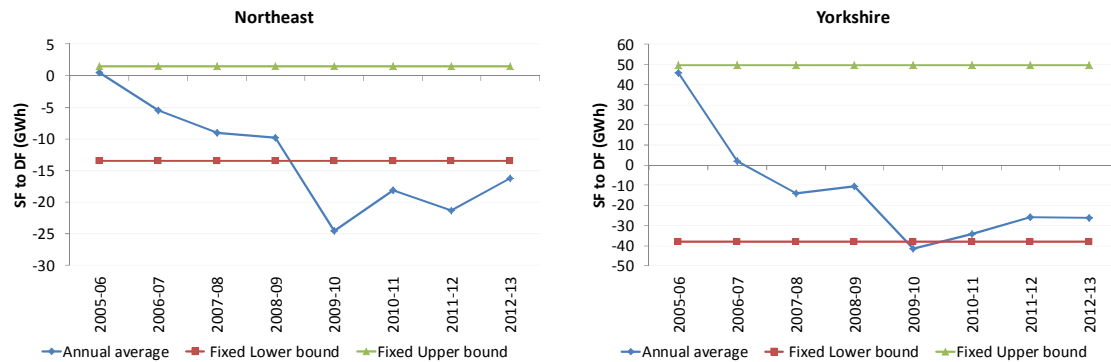
17. All of these factors mean that the confidence interval around the data used to define it is relatively wide. It also means that there is a relatively high probability that it will incorrectly find data to be normal which is in fact abnormal.

18. In other words, the post-2009-10 data may well be abnormal even though it does not quite reach the threshold for a determinative finding of abnormality using Ofgem's chosen 95% confidence interval. In this respect it is relevant that the p-values for 2010-11 are comfortably below 0.15, meaning that abnormality is found at a confidence level of 85%, despite the low power of the test.

³ This evidence is set out below. The section of this application on the pattern on losses over time sets out CUSUM analysis from which it is possible to see the timing of changes in supplier settlements behaviour. The section on evidence provided by energy supply businesses sets out both qualitative evidence from statements made by suppliers in meetings with Northern Powergrid, and quantitative evidence that two energy supply businesses on the number of GVC operations they performed over time.

19. The Decision is silent on whether or not the SF adjustment should be taken into account in applying the test to determine whether later years should be restated. We have prepared this application on the basis that such an adjustment should either be made, or is relevant as additional quantitative evidence in addition to the prescribed statistical test. There are two very compelling reasons why the SF adjustment should be made to the post-2009-10 years.
- a) Firstly, abnormal supplier corrections activity undertaken in 2009-10 (and earlier) will continue to affect SF losses since Engage state that such activity would depress forwards-looking EACs.
 - b) Secondly, there could be ongoing settlements impact from the stop-start recovery from recession. As Engage notes, such effects are difficult to disentangle and best estimated by reference to an earlier normal period.
20. For these reasons, consistency with how the SF adjustment is applied to 2008-09 and 2009-10 is required for the post-2009-10 years. We have therefore also performed the statistical test including the SF adjustment for 2008-09 to 2012-13, rather than just 2008-09 to 2009-10. The results of the statistical test are set out below.

Figure 2: Statistical test results applying the SF adjustment to 2008-09 to 2012-13



21. The test results show that, once the abnormal level of SF during 2010-11 to 2012-13 is taken into account, reconciliations activity in all these years is abnormal in Northeast. In Yorkshire, the width of the confidence interval means that 2009-10 remains the only year to exhibit abnormality at the 95% confidence level. However, the subsequent years are all close to a finding of abnormality. In fact, 2010-11 is very marginal at the 95% level, and shows abnormality at a 93% confidence level, while 2011-12 and 2012-13 comfortably show abnormality at an 85% confidence level.
22. This finding, that additional years are abnormal when the SF adjustment is properly taken into account, is not surprising. As set out below, the level of reconciled losses changed fundamentally following the start of the supplier corrections activity, making a step change to a new higher level. Over time, the effect of the abnormal settlements correction activity by suppliers has shifted from reconciliation runs into a different level of SF losses on an ongoing basis.
23. Had supplier settlements behaviour not changed, then the new higher level of SF losses could have been expected to be offset by subsequent positive reconciliations. The fact

that such subsequent positive reconciliations are not present in the data actually observed must be taken into account in any assessment of the degree to which supplier settlements behaviour over the post-2009-10 years was abnormal.

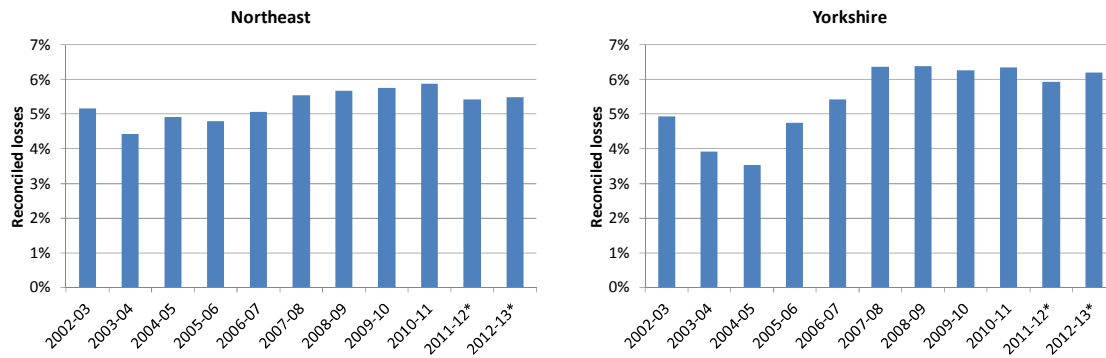
24. Ofgem has itself already recognised the effect of suppliers' use of Gross Volume Correction (GVC) within the settlements process on losses reporting for 2009-10 *and* 2010-11, concluding that *'review work carried out by Elexon supports the view that there may have been a material effect on the level of losses reportable by some DNOs for 2009-10 and 2010-11.'*⁴
25. Bearing in mind that the purpose of the restatement exercise is to get back to the dataset that would have existed had suppliers not changed their behaviour, compared to their behaviour when the price control proposals were made by Ofgem and accepted by DNOs, it would be manifestly irrational and unreasonable to disregard a behavioural change that Ofgem has itself acknowledged has affected years after 2009-10 and where it is at least partially reflected in the SF run and, therefore, is less evident in the subsequent settlement runs.
26. With the SF adjustment taken into account, the post-2009-10 years in Northeast all show abnormal reconciliations. And regardless of whether or not the SF adjustment is applied to the post-2009-10 data in Yorkshire, these years still only fail the test by narrow margins. Given the low power of the test, which increases the likelihood of incorrectly finding abnormal years to be normal, the additional qualitative and quantitative evidence set out below should therefore be sufficient to justify restatement of the data for every year.

⁴ Letter from Rachel Fletcher, 20 July 2010, Ref 87/10.

PATTERN OF LOSSES OVER TIME

27. The pattern of reconciled losses over time shows the effect that abnormal supplier settlements corrections has had on the measure of losses that is used in the DPCR4 close-out. The charts below show reconciled losses from 2002-03.

Figure 3: **Reconciled losses over 2002-03 to 2012-13**

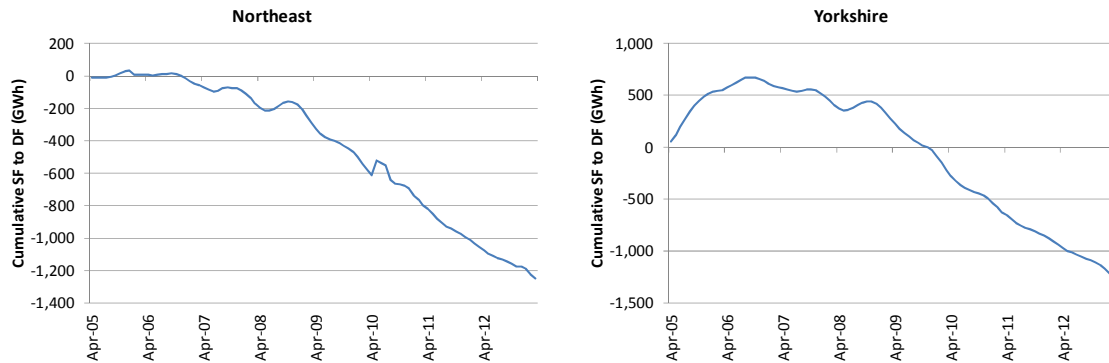


* Data for 2011-12 and 2012-13 is not yet fully reconciled

28. The charts show that over the period 2002-03 to 2006-07 fully reconciled losses ran at a level of around, and often slightly below, 5%. The only exception was one year of slightly lower losses in Northeast, and two years of significantly lower losses in Yorkshire.
29. From 2007-08 onwards, fully reconciled losses stepped up to a new, higher, level. This is the first year affected by large negative reconciliations that were processed in regulatory year 2009-10. From then onwards, losses have remained at or near to this new higher level. In other words, the evidence shows that the effect of the change in supplier behaviour, that is most pronounced in reported data for 2009-10, is continuing to have a clearly visible effect on losses.

30. The effect can also be seen by looking at the cumulative sum of reconciliations received, along with the SF adjustment as calculated for 2008-09 onwards. The charts below show this for Northeast and Yorkshire.

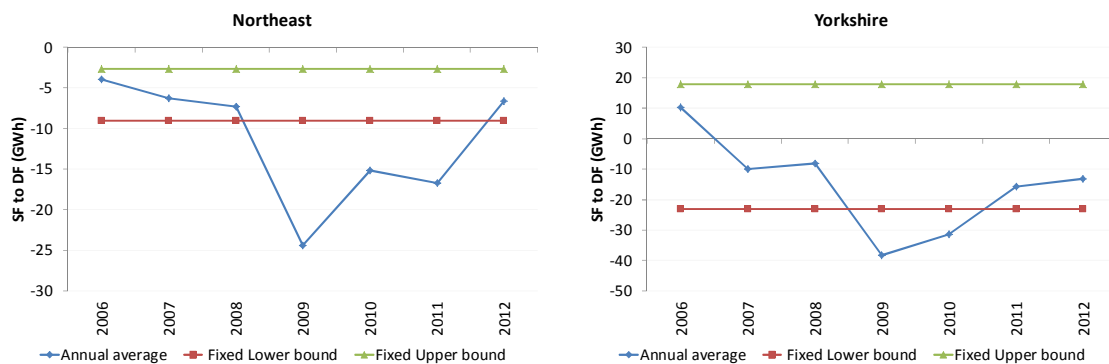
Figure 4: **Cumulative impact of settlements reconciliations and the SF adjustment**



31. We note that the pattern of reconciliations seen over time also has implications for the statistical test. In its August 2012 restatement application, Northern Powergrid identified that abnormally positive reconciliations were experienced in calendar year 2005. Inspecting the cumulative sum charts it is also possible to see that abnormal supplier activity (including the SF adjustment) started in January 2008, abated for several months (reversing much of its impact) then restarted from January 2009.
32. This pattern therefore adds additional variability to the data used to define normal (and abnormal) behaviour for the purposes of the statistical test, since this includes the periods of April to December 2005, and January to March 2009, when reconciliations behaviour was visibly abnormal. This has the effect of increasing the sample variance, in turn widening the confidence interval calculated. As a sensitivity to the statistical test, we have therefore calculated the results using calendar year data, using only 2006,

2007 and 2008, and a critical value for the test's t-statistic which reflects the reduction in the number of degrees of freedom from 3 to 2. The results are set out in the charts below, using the same underlying monthly data as was used for the statistical test results set out in [Figure 1](#) above.

Figure 5: Statistical test results on a calendar year basis, applying the SF adjustment to 2008-09 and 2009-10

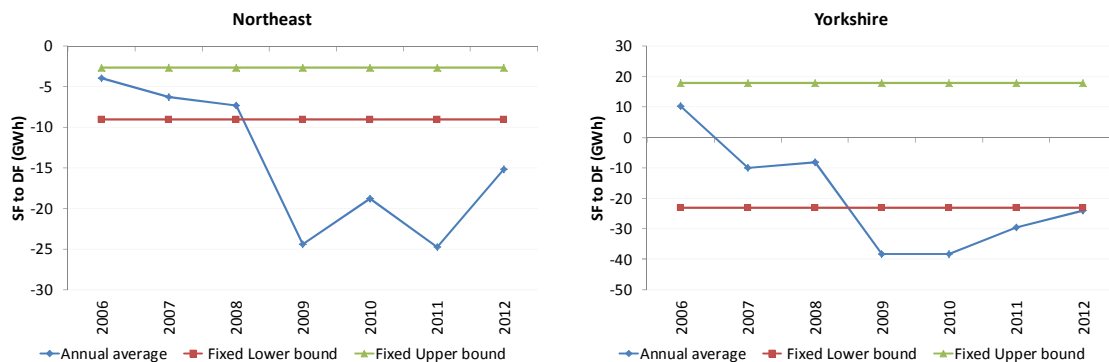


33. The charts demonstrate abnormality of calendar years 2010 and 2011 in Northeast, and 2010 in Yorkshire. This is despite the fact that the reduction in the number of data points to three, and the associated increase in the critical value for the t-statistic, which acts to offset the reduction in the sample variance brought about by a dataset which excluded the abnormally positive reconciliations in 2005, and abnormally negative reconciliations in 2009.
34. The change in the confidence intervals brought about by this move to calendar years is most acute for Yorkshire. The confidence interval narrowed from around 90GWh in the test illustrated in Figure 1 to a little over 40GWh in this test, despite the reduction in

the number of data points by 1 which, all else held constant, acts to widen the confidence interval.

35. As noted at paragraph 19 above, it is also necessary to include an SF adjustment for the post-2009-10 years in order to fully capture any impact the abnormal supplier reconciliations and stop-start recovery from the recession may have had on settlements final, and be consistent with the approach to 2008-09 and 2009-10. The charts below show statistical test results for calendar years, but this time including the SF adjustment for the post-2009-10 years.

Figure 6: Statistical test results on a calendar year basis, applying the SF adjustment to 2008-09 to 2012-13



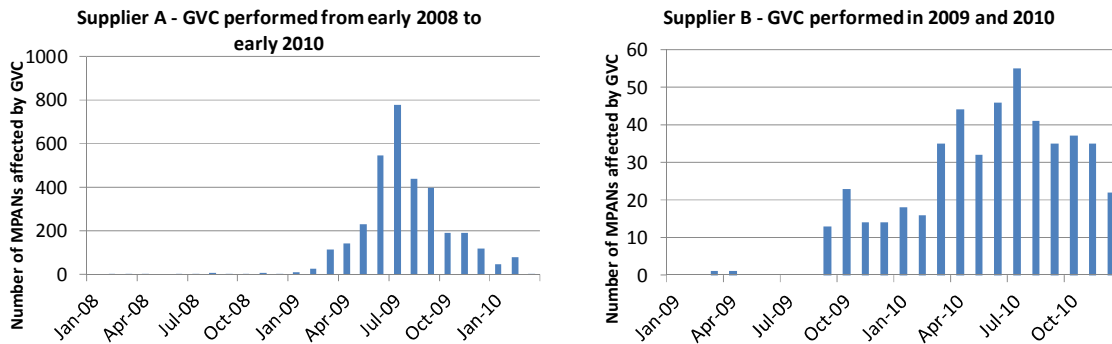
36. The charts show that, having undertaken the test on a calendar year basis to reflect the pattern of supplier reconciliations behaviour seen in the underlying data, and applied the SF adjustment to the post-2009 years, every single year demonstrates abnormality for both licensees.
37. This additional quantitative evidence is a further powerful reason why the reported data for all the post-2009-10 years warrants restatement.

EVIDENCE PROVIDED BY ENERGY SUPPLY BUSINESSES

38. Northern Powergrid met with representatives of several supply businesses during May to July of 2010. While one supplier cited commercial confidentiality as a reason for not answering questions about its data adjustment activity, others were more forthcoming.
- a) Projects to materially change the basis on which the data flowed started as early as 2007.
 - b) Activity varied over time, and could be undertaken in stages, addressing one class of non-half hourly customers before work was undertaken on other classes.
 - c) External consultants were sometimes engaged, although over time the work was moved in-house.
 - d) GVC was commonly used to revise consumption flows, although other techniques were also available.
 - e) At least one supplier took steps to maximise the use of GVC before March 2010, when a rule change came in to limit its use by placing time bounds on its retrospective nature.
39. At Ofgem's suggestion we recently renewed our request to suppliers for information that would help us to quantify the extent of suppliers' data correction activities from 1 April 1998 to the present. Two major energy suppliers were able to supply some data for a small part of this time period, while other small suppliers that responded had only entered the market in recent years. We have received no response from several major energy suppliers at the time of preparing this application.

40. The charts below show the number of meter point administration numbers (MPANs) for which readings were affected by GVC performed by the only two suppliers that provided us with data, during the time period covered by their datasets.

41. Figure 7: **MPANs corrected by suppliers that have provided data**



42. We are unable to use the data provided by suppliers to estimate the volume of electricity involved in these GVC corrections. But the charts do powerfully demonstrate that abnormal levels of GVC were present both in the latter parts of 2009-10, and also during 2010-11.

- a) One of the two suppliers that provided us with data significantly increased its use of GVC during 2009, relative to low background levels during 2008. This activity peaked during June and July 2009, and remained at elevated levels (relative to 2008) during the early part of 2010.
- b) The other supplier that provided us with data significantly increased its use of GVC during late 2009, relative to the low background levels observed prior to this. This continued into 2010, and its activity actually increased further from March 2010 onwards.

43. In other words, abnormal supplier corrections activity using GVC continued beyond 2009-10. The data we have received also gives no reason to suppose that supplier settlements behaviour has more recently reverted to the low levels of background activity seen in the earlier years of the dataset.
44. Furthermore, as we establish in the next section, even if the suppliers' use of GVC had subsided significantly more recently than 2010, the use of GVC will have had a lasting effect on both future reconciliations and SF data.
45. Overall the data provided by these two suppliers gives incontrovertible evidence that, not only is the reported 2009-10 data inconsistent with the basis on which the targets were set, but also that the data from the following years is inconsistent.

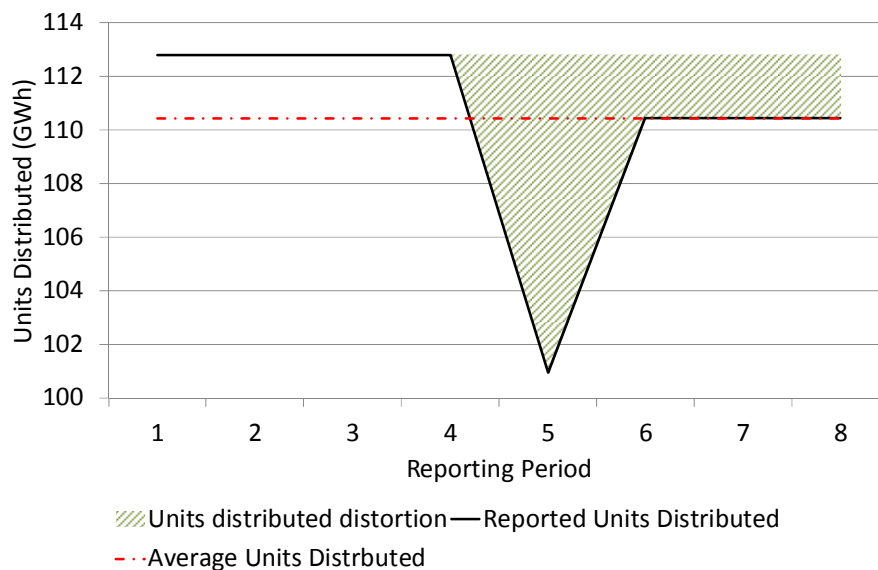
EFFECT OF GVC CORRECTIONS ON SETTLEMENTS

46. As noted by Engage in their paper setting out the SP/Engage method, changes due to the use of settlements correction techniques such as GVC have an impact both on a forwards-looking and backwards-looking basis.
47. Once the technique is used, historical settlements data is revised when a reconciliation run 'opens up' a particular date. On any given day, reconciliations are applied to five different days in the past, at various intervals over the previous 28 months. As each new day passes, new days become open via settlements, and if GVC has been used to change consumption data for an individual MPAN it will lead to subsequent reconciliation revisions becoming more negative than they would otherwise have been. This will continue until all 28 months of historical data have been affected by the

reconciliation runs.⁵ Since five settlement days are open at any given time, the full effect will be seen after less time than 28 months. But all else held constant, the GVC technique will still affect settlements reconciliations for over a year after it is implemented.

48. In terms of its effect on forwards-looking data, the use of the GVC technique will affect the EAC of individual MPANs. The chart below shows a stylised example of how GVC can work in the case of an individual MPAN, which a supplier identifies as having been recording ‘too many’ units distributed. We submitted this stylised chart to Elexon in the days before we prepared this application. Elexon has confirmed that our understanding as set out in this chart is correct.

Figure 8: **Stylised example of the impact of GVC on a single MPAN**



⁵ A rule change by Elexon means that from March 2010 GVC could continue to be used but should not have been applied after RF. Our discussions with Elexon and suppliers have indicated that this rule change may have been interpreted differently by various by suppliers and their data collection agents, potentially limiting its effectiveness.

49. The chart shows a pattern whereby:

- a) In years 1-4 reported settlements data for the MPAN is running at a high level of units distributed.
- b) A supplier which identifies that this historical data flow is erroneously too high for settlements purposes applies GVC to adjust the data to a lower level, on average, potentially over a relatively short period. This leads to a material downwards movement in year 5.
- c) Following the application of GVC the ongoing level of units distributed to the MPAN will be lower in years 6-8.

50. GVC can be used to adjust units distributed both upwards and downwards. But since the technique has predominantly been used by suppliers to remove electricity from the settlement account of the suppliers, it would reduce EACs. Elexon states that *'Applying GVC to compensate for an earlier excessively large AA [annual advance – used to set consumption for settlements purposes], can result in a negative AA. Depending on the size of the negative AA and the duration of the Meter Advance Period, the associated forward-looking EAC can also be negative or much lower than the likely rate of consumption for the Metering System.'*⁶

51. These reduced forwards-looking EACs are then used to estimate ongoing consumption at the MPAN for SF units distributed, so the use of GVC that led to abnormally negative reconciliations would also have had the effect of depressing SF in future. From June 2010 onwards, Elexon has replaced negative EACs with class average values. But EACs that were reduced due to the use of GVC, without becoming

⁶ Elexon, 13 March 2013, Gross volume correction guidance, version 3.0

negative, would not be affected by this rule change. In other words, there is a clear transmission mechanism between abnormal settlements corrections activity that was seen in 2009-10, and the ongoing level of SF. This transmission effect is still present, despite rule changes which should have reduced its strength from June 2010 onwards.

52. This is one of the reasons why Ofgem must be open to considering additional evidence that the post-2009-10 years remain abnormal, even if the prescribed statistical test does not clearly demonstrate this. In the subsequent years, abnormal activity continuing at the same level as in 2009-10 would be less apparent in reported data, partly because the activity in 2009-10 will continue to propagate into SF, and partly because suppliers would have already had the opportunity to undertake some of the adjustments that their new behavioural standard is consistent with, such as adjustments already made to the 2007-08 and 2008-09 reconciled datasets during the 2009-10 reporting year. But that is not to say that supplier behaviour reverted to its earlier standard. Indeed, there were still significant volumes of negative reconciliations affecting 2009-10 being undertaken in the subsequent years. It simply means that the data generating process will tend to mask continued abnormal activity when applying Ofgem's prescribed statistical test to reported data.

53. In other words, such additional evidence of continuing abnormal activity may in fact be more relevant for the subsequent years than for 2009-10, since by definition the nature of the activity and settlements systems means that continuing abnormal activity is less likely to be identified by the prescribed statistical test than abnormal activity in 2009-10.

RESTATEMENT OF LOSSES FOR THE CLOSE-OUT

54. The Decision stipulates that the restatement of losses must be undertaken using the SP/Engage method. Furthermore, it also stipulates:

- a) The variant of the methodology known as 'Approach C' must be used, as described in Appendix 2 to the decision.
- b) The normal period for SF losses, and reconciliation runs, must be April 2006 to March 2008.
- c) Seasonality must be preserved in restated SF losses, by normalising any given month using the weighted average SF losses for corresponding months in the normal period.
- d) Restated reconciliations must be calculated separately for each run type using weighted average reconciliations as a percentage of SF units exiting in the normal period for that run type.

55. Our calculations and methodology are identical to those used in our previous restatement application for approach C, except for changes necessitated by requirements b) and c) above. We can confirm that we have implemented approach C by applying the SP/Engage method to reported data, in order to calculate restated reported data for 2009-10 and the subsequent years. We have then fully reconciled the resulting dataset. The restated losses which result are set out in the table below.

Table 1: Restated fully reconciled losses in 2009-10 for the purposes of the close-out of the DPCR4 incentive

	Northeast	Yorkshire
<i>Losses (% units exiting)</i>	4.9%	5.0%
<i>LUD (GWh)</i>	15,791	23,039
<i>ACL₂₀₀₉₋₁₀ (GWh)</i>	766	1,153
<i>DCPR4 period net close-out (£m)</i>	2.7	10.7

56. Accordingly, Northern Powergrid now applies to restate its 2009-10 fully reconciled losses on this basis.⁷

RESTATEMENT OF LOSSES FOR THE ANNUAL INCENTIVE

57. The Decision stipulates that the restatement of 2009-10 losses for the purposes of the annual incentive must be undertaken by applying the same restatement approach as for close-out but with the exception that data should be left on a reported basis (and not fully reconciled).
58. The restated losses which result for the purposes of the annual incentive are set out in the table below. We have not placed a financial value on the annual incentive, as this would not affect the value of the close-out. However, we note that the results of the restatement will have implications for the value of the 2009-10 growth term.

⁷ Ofgem's Decision states that it is minded to apply a new approach to calculating a cap. If the cap is implemented as per Ofgem's proposal, it would act to increase Northern Powergrid's losses for the close-out and reduce the value of the restatement under this application. We have not reflected the proposed cap in this application as the approach is still subject to consultation. We expect to make representations on its implementation in a subsequent submission.

Table 2: Restated reported losses in 2009-10 for the purposes of the annual incentive and the growth term

	Northeast	Yorkshire
<i>Losses (% units exiting)</i>	4.9%	5.2%
<i>LUD (GWh)</i>	15,788	23,034
<i>ACL₂₀₀₉₋₁₀ (GWh)</i>	768	1,203

59. Accordingly, Northern Powergrid now applies to restate its 2009-10 reported losses on this basis.

CONCLUSIONS

60. Ofgem has consistently recognised that the purpose of the restatement exercise is not to arrive at the correct statement of the level of electrical losses in 2009-10 but to arrive at the dataset that is most consistent with the dataset that would have resulted had suppliers not changed their behaviour.
61. Restatement is needed to restore consistency between the basis on which the targets were set and the basis on which performance against those targets is to be measured to close-out the DPCR4 incentive. The fundamental importance of restoring consistency between targets and reported outturn has been recognised by Ofgem in its several decisions dating back to 2009. It is important that this purpose continues to guide Ofgem in its treatment of the applications that it receives following the publication of the Decision.

62. In this application, we have demonstrated that abnormal activity in supplier settlements behaviour occurred, to an extent that warrants restatement in order to ensure consistency with the basis on which targets were set.

- a) During 2009-10, the requirements of Ofgem's prescribed statistical test for abnormality are satisfied and there is no need to consider further evidence.
- b) During the post-2009-10 years, the abnormal activity continued, but its effect is less likely to be confirmed only with reference to the prescribed statistical test due to the impact of GVC on settlements. The transmission mechanism is likely to have changed, since abnormal activity in 2009-10 will have propagated into abnormal SF in subsequent years. Even though there were significant volumes of negative reconciliations during the subsequent years, affecting reconciled 2009-10 data, the prescribed statistical test is less likely to identify abnormality. Consideration of additional evidence relating to these years is therefore warranted.
- c) As Ofgem notes, the prescribed statistical test has low power, giving a high probability of falsely classifying abnormal activity as normal. This is compounded by the use of some abnormal data in the benchmark for normality. By limiting the test to the three calendar years least affected by abnormal activity, and making an SF adjustment for the post-2009-10 years, we find evidence of abnormality for both licensees, in every year.
- d) Inspecting the pattern of reconciled losses over time, there is clear evidence that the change in supplier behaviour led to an upwards step in losses, from 2007-08 onwards, which has not been reversed to date.

- e) Lastly, recent evidence from suppliers on the extent of GVC activity confirms that it ran at abnormal levels during 2009-10 and 2010-11, and gives us no reason to believe that settlements behaviour has returned to normal subsequently.

63. In light of this compelling evidence, our restatement has been prepared on the basis that 2009-10 and the subsequent years, for both Northeast and Yorkshire, warrant restatement. Applying the SP/Engage method to our reported data, then fully reconciling the dataset, gives normalised losses for the purpose of the DPCR4 period close-out of 766 GWh in Northeast, and 1,153 GWh in Yorkshire. Applying the SP/Engage method to our reported data without reconciliation, as required for the purposes of the 2009-10 annual incentive and growth term, gives normalised losses on 768 GWh in Northeast and 1,203 GWh in Yorkshire.