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9 Millbank
London
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Lloyds Court
78 Grey Street
Newcastle Upon Tyne
NE1 6AF

2 August 2013

Dear Dora

Losses incentive close-out restatement application

Please find attached an application to restate 2009-10 units distributed and losses for the purposes of the losses incentive close-out and 2009-10 annual incentive. This submission is made on behalf of Northern Powergrid (Northeast) Ltd and Northern Powergrid (Yorkshire) plc, and has been prepared in accordance with the requirements of the document titled *Decision on the process to follow for closing out the losses incentive mechanism for the fourth distribution price control (DPCR4)* (the Decision).

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.

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.

In the attached 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.

- During 2009-10, the requirements of Ofgem's prescribed statistical test for abnormality are satisfied and there is no need to consider further evidence.
- 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

NORTHERN POWERGRID

is the trading name of Northern Powergrid (Northeast) Ltd (Registered No: 2906593) and Northern Powergrid (Yorkshire) plc (Registered No: 4112320)

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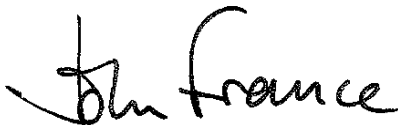
negative reconciliations during the subsequent years, affecting reconciled 2009-10 data, the prescribed statistical test is less likely to identify abnormality. Consideration of additional evidence relating to these years is therefore warranted.

- 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.
- 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.
- 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.

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. This restatement results in a losses percentage for the purposes of the DPCR4 incentive close-out of 4.9% for Northern Powergrid Northeast, and 5.0% for Northern Powergrid Yorkshire.

We hope that our restatement application provides you with all the information you require. But if you have any further questions, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink that reads "John France". The signature is written in a cursive, slightly stylized font.

John France
Regulation Director