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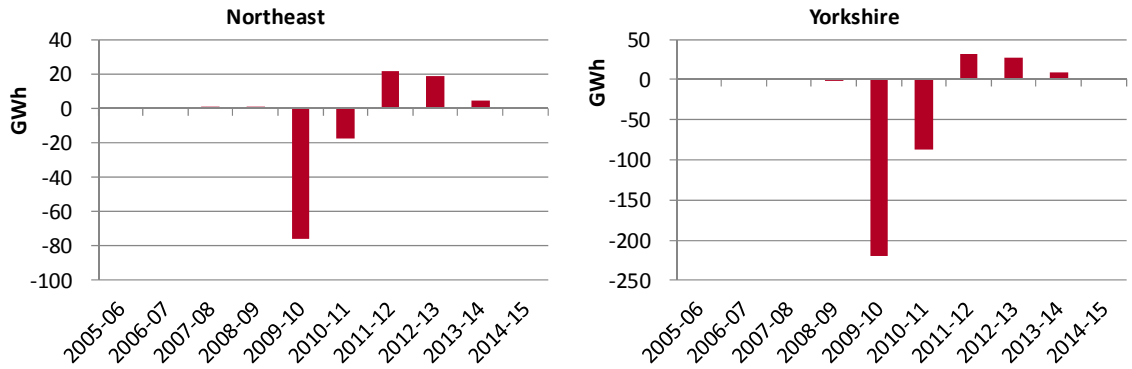
Dear Tim

Further analysis on supplier data

Thank you for your questions regarding our analysis on when supplier data corrections will have affected settlements reconciliation runs. It is of some comfort to us that our analysis is being considered seriously and that we are being given the opportunity to respond to the comments that you have.

Yesterday morning you called Peter to discuss the assumption we had made regarding which settlements run each data correction would have flowed through. We had simplified the calculations by making an assumption that we felt would give a reasonable approximation. This assumption had the benefit of making the analysis significantly more tractable, but you felt that that there was scope for it to be unduly favourable, and wanted to understand how sensitive our results were to it. As Peter has already informed you, we have now refined our analysis to remove the need for this assumption, by applying a much more complex set of calculations which take into account the settlements runs which were open when any given correction was applied. Overall, the new calculations give similar results to our previous analysis. These new results are shown in the charts below.

Figure 1: Results of further analysis on the impact of supplier settlements corrections on reconciliations flowing via settlements



2010-11 is the year for which we drew the strongest conclusions from our previous analysis. Comparing these results to those from our original analysis, approximately one third of the net-negative corrections volume affecting 2010-11 have been re-allocated to 2009-10. Even with this change, we still find that a significant volume of net-negative reconciliations affected

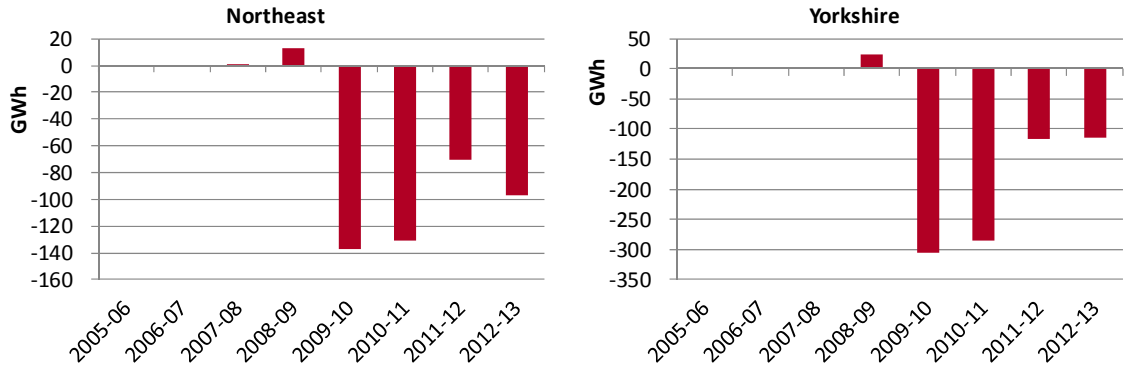
settlement reconciliation runs which took place during 2010-11, as a result of the corrections activity covered by the supplier dataset published in January. In 2010-11 the corrections covered by the dataset will have resulted in reconciliations amounting to almost -20GWh in Northeast and almost -90GWh in Yorkshire. These amounts are significant in the context of measured losses for both licensees.

Moreover, when we apply Ofgem's statistical test to these refined results we arrive at the same conclusion: reconciliations which flowed during the post 2009-10 years as a result of supplier corrections activity were abnormal relative to the behavioural standard that existed in the corrections dataset before 2009-10. I attach with this letter an updated version of the spreadsheets I had previously sent you supporting these statistical test results.

Of course, as you know, supplier GVC corrections will also have had an ongoing effect on settlements processes through routes other than reconciliations, and in particular through their impact on estimated annual consumption values. In the results above we have not attempted to quantify this, limiting the exercise exclusively to the impact of the supplier corrections on settlements reconciliation runs. But in our restatement application we did quantify this, by comparing the settlements final value seen in the post 2009-10 years with the value seen in the normal period.

The charts below includes this estimate of the impact the corrections had via settlements final, along with impact on reconciliation runs shown in Figure 1 above.

Figure 2: Results of further analysis on the impact of supplier settlements corrections on reconciliations and settlements final data



As you can see, once we include an estimate of the impact the corrections had on settlements final, the abnormality of the losses data flows in 2010-11 is acutely apparent, a finding which is confirmed by Ofgem's statistical tests. 2011-12 and 2012-13 remain abnormal (when Ofgem's statistical test is applied), but we accept they are less so.

Overall we remain of the view that the supplier dataset on corrections activity is a useful additional piece of information. It has to be considered in the context of Ofgem's vanilla statistical tests, on which 2010-11 narrowly fails to be identified as normal. Despite their low power, the tests give quite a strong indication that abnormality may well be present, and although the results do not meet Ofgem's required level of confidence (as specified as part of the test) they do not fall far short.

Our analysis of this further data, as well as the other evidence presented in our application, should give Ofgem the additional confidence required to find that the 2010-11 data, in both our licensees, is in fact abnormal, due to the abnormal supplier corrections activity which we have proven took place.

We of course remain available to answer any further questions you might have, and undertake analysis at short notice if this would be helpful.

Yours sincerely

Keith Noble-Nesbitt
Economic Regulation Manager