

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

Final decision

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Overview:

We have consulted extensively over the past four years on aspects related to closing out the Losses Incentive Mechanism in the Fourth Distribution Price Control (DPCR4).

In October 2013 we published a consultation on the restatement of losses performance for 2009-10 and the final incentive values under the DPCR4 losses mechanism. The values were calculated based on decisions up to and including those in that consultation document. Most notably this included the decisions we made in July 2013 that enabled distribution network operators (DNOs) to submit final data for this purpose.

Having analysed the responses to the consultation this document contains the further decisions we have made and final values necessary to close out this mechanism. Alongside this document we have published a direction with the final values to be recovered by each DNO.

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. This affected the 2009-10 data in particular. We established a process to make adjustments to this data prior to determining the DPCR4 close out values.

This document contains the final decisions on the restatement of losses performance for 2009-10 and the final incentive values 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. This decision follows our consultation in October 2013. A small selection of relevant documents is presented below:

Further consultation on restatement of 2009-10 data and closing out the DPCR4 losses incentive mechanism - 21 October 2013

<https://www.ofgem.gov.uk/publications-and-updates/further-consultation-restatement-2009-10-data-and-closing-out-dpcr4-losses-incentive-mechanism>

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

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 reasons, such as theft. To encourage distribution network companies (DNOs) to manage losses efficiently across their networks, we introduced a losses incentive mechanism. The fourth distribution price control (DPCR4) losses incentive mechanism covered the period from 2005-06 to 2009-10.

The DNOs calculated their losses by estimating the difference in the electricity flowing in and out of their networks, principally measured by "settlement data". We designed the mechanism as an outputs-based incentive, with the incentive value based on each DNO's reported losses levels compared with its individual target. This was to incentivise DNOs to reduce losses in the most efficient way for their circumstances. We were not seeking details of the actions taken by DNOs under this incentive.

Suppliers conduct data cleansing activities to correct errors and improve the accuracy of the settlement data, which affects the units distributed reported by DNOs. Unusually high levels of data cleansing increased the reported losses for most DNOs for 2009-10. This affected the incentive (penalty or reward) some DNOs received for 2009-10, as well as the final value of the incentive, which is based on the performance in 2009-10.


Since 2010 we have worked extensively with industry to find ways to resolve this issue. We have published several consultations and decisions on the matter. Where abnormal levels of settlement data corrections have occurred, we believe that allowing DNOs to restate their data is, on balance, in the interest of consumers. This is because it helps preserve the intent of the incentive and maintains regulatory certainty.

In October 2013, we published a final consultation to seek views on how we have assessed applications from 11 DNO licensees to have their 2009-10 losses positions restated. We published our analysis of the restatement applications for closing out the DPCR4 incentive mechanism based on the framework in our July 2013 document.

This decision

In this document, we set out decisions on closing out the DPCR4 losses incentive mechanism. This allows us to calculate the residual values of the incentive for each DNO, published in the direction that accompanies this decision.

Our decisions on the close out values result in DNOs collectively returning £161 million to customers. This is a £65 million increase compared with the £96 million in our October 2013 consultation. DNOs will be returning money to customers as a result of recovering £317 million earlier in the DPCR4 period.



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Of this total to be returned to customers, DNOs applying for restatement will be returning £222 million. After returning this money these DNOs will have received overall rewards of £75 million for the entire DPCR4 period, compared with a penalty of £334 million without the restatement.

The final close out values for the three DNO licensees that have not applied for restatement results in an overall reward of £81 million. On that basis, the overall value of the DPCR4 losses incentive mechanism is a net reward of £156 million to the DNOs. This is significantly lower than the total reward of £424 million that would arise if we were to accept the DNOs' submissions without change.

The reduction in rewards to DNOs results from the decisions we have made on the close out process. Most notably, to protect consumers from unreasonable outcomes, we have decided that the restatement submissions should be capped at the higher of two thresholds: six per cent below the target losses or six per cent below the normal period losses. We have rejected the only application for an alternative normal period on the basis that the applicant did not provide strong evidence that the alternatives proposed were appropriate. We have accepted additional evidence for abnormality in 2009-10 provided by DNOs where DNOs have not identified abnormality in the statistical test. Although we accept the principle that additional evidence may be used to support additional abnormality in years beyond 2009-10, we have rejected the cases presented as insufficiently strong.

The figures above are presented in 2009-10 values. We have decided that they should be rebased to 2012-13 prices using the retail prices index. Thereafter a time value of money adjustment will be applied. The time value of money adjustment will be the compounded impact of the Bank of England interest rate plus 1.5 percentage points in each year from 2012-13 to the year of recovery. The direction that accompanies this decision governs the amount to be recovered by each licensee for each year from 2015-16, calculated to not exceed three per cent of forecast Base Demand Revenue for 2015-16. The exception is for 2016-17 for which we have taken into account prior provision for recovery of close out amounts in directing the value for that year. We have smoothed the recovery in order to limit volatility in resulting charges.

We have also decided the final impact of the restatement on the growth term for 2009-10 for DNOs applying for restatement. The total value left to recover is £0.2m across the DNOs, in 2009-10 prices. We do not consider it appropriate for DNOs to have to resubmit all revenue returns from 2009-10. We also do not consider that the methodology for setting the final PPL values allows for the growth term value to be taken into account. We will consult separately on a change to the licence to allow for a revenue adjustment to take account of the growth term restatement. We have decided that these values should be uplifted by weighted-average cost of capital plus RPI indexation up to the year of recovery.

1. Introduction

Chapter Summary

This chapter provides background to the issues covered and explains the structure of the document.

1.1. This document explains our decisions in closing out the DPCR4 losses incentive mechanism. It represents the culmination of extensive stakeholder engagement including our final consultation, published on 21 October 2013. Alongside that consultation, we published the data submissions from each of the DNOs. We have since published the responses to the consultation, some further data from suppliers and the additional responses from stakeholders analysing this further data. We would like to thank stakeholders for their extensive engagement throughout this process.

1.2. The decisions in this document enable us to calculate the residual values of the mechanism for each DNO, published in the direction that accompanies this decision. This document includes further decisions following our last consultation and, where relevant, relies on previous decisions we have made on this subject and are standing by. It also finalises the DNO revenues related to annual reporting for 2009-10. These two elements are explained below.

Background

Distribution losses incentive mechanism

1.3. 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. Electricity that flows off the network is described as “units distributed”. The measured electricity 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).

1.4. As more meters are read in the period after the energy flows, the measurement 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

¹ DPCR4 covered the regulatory years 2005-06 to 2009-10.

period. DNOs' reporting of settlement data was based on either the RF (run final) or DF (dispute final) data sets.

1.5. We designed the mechanism as an outputs-based incentive. The value of the incentive is based on each DNO's losses in comparison with its individual target. This was to incentivise DNOs to undertake the most efficient actions to reduce losses in their circumstances. We were not seeking details of the actions taken by DNOs under this incentive.

Target setting and DNO methodologies

1.6. For DPCR4 we set 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. Outperformance relative to the target resulted in a reward to DNOs, while underperformance resulted in a penalty. On each side of the target, the incentive level was the same at £48 per megawatt-hour (MWh) (or around £57/MWh in 2009-10 prices).

1.7. During the DPCR4 period, the performance of each DNO was measured according to the DNOs' own reporting methodologies. Different DNOs have different methodologies. To ensure consistency with the way targets were set, DNOs reported their losses performance in accordance with their particular methodology.²

Close out

1.8. 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.³

1.9. DNOs received/incurred annual rewards/penalties during DPCR4 based on reported losses performance against their targets. These incentives 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.

1.10. The close out calculation for DPCR4 derives the final losses incentive for each DNO for the price control period. The residual value left to be recovered is referred to

² DPCR4 Special Licence Condition C1(9) – this provided that the licensee should calculate losses on the same basis (ie the same methodology) as that in 2002-03, unless the Authority has agreed otherwise.

³ DPCR5 is the existing price control period. <https://www.ofgem.gov.uk/ofgem-publications/45537/methodology-closing-out-dpcr4-losses.pdf>

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, the total value of the incentive), less
- the sum of incentives received/incurred from 2005-06 to 2009-10.⁴

1.11. E is the losses performance in 2009-10 on a fully-reconciled basis.⁵ It is the main focus of Chapter 2, 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.

1.12. In short, the close out value determines the final incentive amount incurred/received by each DNO for the entire DPCR4 period.⁶

Data cleansing affecting losses performance

1.13. Suppliers may conduct data cleansing activities to correct errors and improve the accuracy of the settlement. This includes a technique called gross volume correction (GVC).⁷ 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 at Appendix 3.

1.14. Data cleansing is an ongoing process. However, during 2010 some DNOs noted high levels of data corrections. Changes to the Balancing and Settlement Code (BSC) which became effective from March 2010 may have prompted suppliers to accelerate their use of GVC for billing adjustments, as the changes were designed to limit the use of GVC. This affected the calculation of the close out position for DPCR4 since 2009-10, the final year of DPCR4, is fundamental to the close out calculation.

Addressing abnormal levels of data cleansing


⁴ Any incentive for one-off performance over the period is effectively clawed back.

⁵ Reporting the data in relation to the period during which the energy flowed rather than the period that the data was received.

⁶ The calculation is explained in our methodology document:

<https://www.ofgem.gov.uk/ofgem-publications/45537/methodology-closing-out-dpcr4-losses.pdf>

⁷ GVC is used in the settlement process as a last resort method of correcting meter data and estimated annual consumption levels where errors have affected days whose final reconciliation has passed.



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1.15. Since 2010 we have been extensively involved with industry in seeking to resolve the issue of the impact of abnormal levels of data cleansing affecting 2009-10 on the close out of the DPCR4 losses incentive mechanism. We have allowed DNOs to apply to restate their data in 2009-10 where it can be demonstrated that the data was affected by abnormal levels of data cleansing.⁸ In such cases we believe that allowing DNOs to restate their data is, on balance, in the interest of consumers.

1.16. Given that the abnormal levels of data cleansing did not emerge until the end of the DPCR4 period, we consider that the incentive was capable of encouraging the right behaviour during the period. Therefore, we do not consider it in the interests of consumers to undo an incentive mechanism which we believe was capable of being effective for the majority of its duration. The need to uphold a stable and fair regulatory environment that encourages efficient behaviour by DNOs is imperative. We are concerned that to zero out the mechanism could undermine the regulatory regime and ultimately be to the detriment of consumers.

1.17. We provide more details of the components of the restatement process at Appendix 3. Put simply and at a high level, restatement allows a DNO to submit revised data for 2009-10 losses. Data for years from 2009-10 to 2012-13 that are identified as abnormal under our stipulated statistical test are replaced with an estimate of what the data would have been in the absence of abnormal effects resulting from unusual levels of data cleansing. Due to the acknowledged low power of the statistical test, DNOs may also provide other evidence that their data is abnormal. DNOs follow a specific methodology for estimating the revised losses with reference to data earlier in the price control period. That estimate is then subjected to a reasonableness check (the credibility cap) to limit the scale of potential over-recovery and consequential detriment to consumers.

1.18. Our October 2013 consultation contained our draft PPL values based on DNOs' restatement applications. These values and the methodology for restatement had been revised following responses to the approach in our November 2012 consultation on this issue.⁹ Over 2013, we worked with industry to resolve the issues raised by the consultation responses, and we considered and improved both the methodology and the data used for restatement. In July 2013 we made a number of important decisions that allowed DNOs to submit the close out data and restatement applications on which we consulted in October 2013. These decisions included the data to be used, the statistical test and the precise restatement methodology to follow.

⁸ More detail can be found on the Ofgem website:

<https://www.ofgem.gov.uk/electricity/distribution-networks/losses-incentive-mechanism>

⁹ Our November 2012 consultation presented draft close out values on the basis of DNO submissions in response to our July 2012 data request.

<https://www.ofgem.gov.uk/publications-and-updates/consultation-restatement-2009-10-data-and-closing-out-distribution-price-control-review-4-dpcr4-losses-incentive-mechanism-document-g>

1.19. To assist the consideration of this matter, since the October 2013 consultation we have published on our website:

- Western Power Distribution's application for alternative normal periods that could be used for the restatement of its East Midlands licensee (November 2013)
- The ten stakeholder responses to the October 2013 consultation (December 2013)
- Evidence of data cleansing provided by suppliers (December 2013 and January 2014)
- The five stakeholder responses to the suppliers' evidence of data cleansing (January 2014).

1.20. We are also publishing Northern Powergrid's further analysis of the suppliers' evidence alongside this decision.

The growth term

1.21. 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.

1.22. However, the Base Demand Revenue¹⁰ 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, was an incentive mechanism that rewarded DNOs for increasing units distributed. This incentive was distinct from the losses incentive mechanism but used common data. 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.

Framework for consideration

1.23. 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 making our decisions we have applied the requirements set out in those provisions.

¹⁰ DPCR4 Special Licence Condition B1.

1.24. In the context of these decisions, 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.
- 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

1.25. Chapter 2 sets out our decisions related to closing out the DPCR4 losses incentive mechanism. Our decisions address issues raised by respondents to the October consultation. In some sections we reiterate the rationale for standing by decisions that we have taken early in the process and recorded in earlier documents. These cover:

- the overall credibility of the incentive
- the data to be used by the DNOs
- statistical robustness
- targets for the close out and indexation of incentives received.

1.26. In other sections we make decisions on the main issues that we consulted upon in October 2013:



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- credibility cap
- normal period
- other evidence for abnormality
- recovery.

1.27. These decisions have allowed us to calculate the final incentive amount for each licensee.

1.28. Chapter 3 covers the decisions as they relate to restatement of losses data for the annual incentive in 2009-10.

1.29. Chapter 4 outlines how the final values will be recovered and includes reference to the direction that accompanies this decision.

1.30. We have also produced a number of appendices that give further detail on certain aspects of the process and analysis of the final position. They are referred to in the main document, as appropriate.

2. Close out of DPCR4: Final PPL terms

Chapter Summary

This chapter contains our decisions related to closing out the DPCR4 losses incentive mechanism. It considers responses to our October 2013 consultation and subsequent evidence, explaining how we have reached our final decision. It contains the final PPL terms for each DNO, which have also been published in the direction that accompanies this decision.

Overall credibility of the DPCR4 losses incentive mechanism

2.1. Some respondents questioned the rationale of continuing the restatement process in the context of volatile data and final outcomes that are necessarily estimates. We consider there is merit in addressing these issues up front before giving more detail on the decisions we have made.

Our decision

2.2. We continue to consider that to progress with the restatement process is in the best interests of consumers. We are not revisiting our decision to permit restatement in principle.

Summary of our consultation position

2.3. Our October 2013 consultation was the latest stage in a process that began in 2010. In November 2012 we decided, following consultation, not to activate the losses incentive mechanism for DPCR5 as we could not continue to support an incentive mechanism that results in large-scale unpredictable rewards and penalties.

2.4. In that decision we acknowledged that, while some of the problems with the mechanism were known during DPCR4, the most significant concerns only crystallised in recent years. The energy to which the close out values relate ceased to flow in March 2010. For these reasons, and because of the significant detrimental impact on regulatory certainty that would arise if we were to unpick part of the DPCR4 settlement, we were not prepared to go as far as unwinding the DPCR4 losses incentive mechanism.

2.5. The October consultation presented our assessment of the DNO submissions for restatement.

Consultation responses

2.6. Two DNOs offered comments on the overall credibility of the outcome noting differences between DNOs. One of these respondents suggested that, with demand falling, the differences between reported losses and the target are not physically possible in some instances. It was concerned that some DNOs will receive large rewards while others will receive large penalties. It suggested that these outcomes may affect competition in the supply market depending on the supplier market share in different DNO areas. Both respondents suggested zeroing out the mechanism if stakeholders are unable to agree on an equitable outcome.

2.7. Two suppliers also suggested either zeroing out the mechanism or proceeding with close out without restatement. The two suppliers expressed concern that the vanilla assessment¹¹ presented in the consultation represents a £473 million reward for DNOs compared with the outcome if no restatement is permitted. They were concerned with the overall level of the reward proposed given the lack of evidence of actual investment or consumer benefits commensurate with this level of rewards.

2.8. In its response one supplier also included rewards received by DNOs during DPCR4 for units distributed in the previous price control (DPCR3) in its analysis.

Our response to issues raised

2.9. We have undergone an extensive process to estimate losses in 2009-10 were there no abnormal levels of data cleansing. We have developed the methodology following extensive consultation with industry and have introduced a credibility cap to ensure the exposure of consumers is limited. In this process we have sought to maintain regulatory certainty and to uphold the intent of the DPCR4 losses incentive mechanism as stated in our DPCR4 and DPCR5 Final Proposals.¹² We consider that to zero out the mechanism at this stage would fundamentally undermine regulatory certainty and set an unwelcome precedent.

2.10. We designed the mechanism as an outputs-based incentive, with the value of the incentive based on a data-derived measurement of losses. This was to allow DNOs to undertake the most efficient and appropriate actions to reduce losses for their circumstances. We were not seeking details of the actions taken by DNOs under this incentive.

¹¹ The assessment of restatement submissions based on the framework in our July 2013 document.

¹² The DPCR4 losses incentive mechanism was put in place in DPCR4 Final Proposals (November 2014) and the close out process was finalised in DPCR5 Final Proposals (December 2009).

2.11. Given that the abnormal levels of data cleansing did not emerge until the end of the DPCR4 period we consider that the incentive was capable of encouraging the right behaviour during the period. Therefore, we do not consider it in the interests of consumers to undo an incentive mechanism which we believe was capable of being effective for the majority of its duration. The need to uphold a stable and fair regulatory environment which encourages efficient behaviour by DNOs is imperative. We are concerned that to zero out the mechanism could undermine the regulatory regime and ultimately be to the detriment of consumers.

2.12. While we acknowledge the differences in outcomes between DNOs, we did not expect all DNOs to receive the same overall incentives from this outputs-based mechanism. The credibility cap (covered below) serves to narrow the differences in the outcomes between DNOs applying for restatement.

2.13. DPCR5 Final Proposals is clear that the close out of the DPCR4 losses incentive mechanism should be net of incentives already received/incurred for units distributed after 1 April 2005, ie during DPCR4. Therefore, in calculating the overall value of the incentive we have excluded credit for units distributed during DPCR3, which attracted a different incentive rate.

Data used

Our decision

2.14. We stand by our decision, set out in the October consultation, that data submitted is appropriate for the purpose of closing out the mechanism.

2.15. The DNOs submitted data in response to the decisions in our July 2013 document. A further audit of the data that the DNOs submitted initially brought up some additional issues. Working with our auditors, we resolved these issues bilaterally with the DNOs. The issues and their resolution are documented in the October consultation and its associated data audit report.¹³

Summary of our consultation position

2.16. Our October 2013 consultation set out the conclusions from the extensive analysis and independent data audit process that we commissioned in light of responses to our November 2012 consultation. In our October 2013 consultation we stated that we are satisfied that the data submitted for close out is sufficiently robust and fit for purpose.

¹³ <https://www.ofgem.gov.uk/publications-and-updates/further-consultation-restatement-2009-10-data-and-closing-out-dpcr4-losses-incentive-mechanism>

2.17. Our consultation included details of UK Power Network's (UKPN) treatment of data management units (DMUs) in response to our decision in the July 2013 document, and in particular, DMUs relating to years beyond DPCR4. We stated, following advice from our independent auditors, that we are satisfied with UKPN's treatment of these units.

2.18. We published each DNO's submissions alongside the consultation.

Consultation responses

2.19. Most of the comments received related to specific concerns with the treatment of certain DNOs. One respondent made a general comment regarding the difference in our acceptance of data between different DNOs. In particular, the respondent was concerned that we required DNOs to only use settlement data consistent with their methodologies as in its view this created inequitable and unjustifiable disparities.

2.20. Specific comments related to the treatment of particular DNOs in terms of the data used in the close out process, including:

- The Scottish & Southern Energy (SSE) licensees using settlement data, unrelated to the basis on which their targets were set.
- Only one DNO being allowed to close out on the RF (rather than DF) settlement run giving it an unfair advantage.
- The extent to which any non-settlement data adjustments under UKPN's or Western Power Distribution's (WPD) methodologies should be allowed.
- UKPN not providing satisfactory evidence to justify including non-settlement units found in post-DPCR4 years that relate to energy flowing in 2009-10, especially those after July 2012, the date on which the DPCR4 incentive was intended to be closed. For its part, UKPN stated that it had not yet accepted our proposed treatment of DMUs.

Our response to issues raised

2.21. Two principles, worth reiterating, have informed our consideration of the data audit and issues raised by it. These principles have been informed by balancing the intention of DPCR5 Final Proposals to close out the DPCR4 losses mechanism using fully-reconciled settlement data while recognising the individual DNOs' methodologies. They concern the differences between using adjusted and unadjusted settlement data for close out:

- SSE has relied on the DPCR5 Final Proposals to allow it to use unadjusted settlement data for the purposes of the close out. Other DNOs have departed from unadjusted settlement data in accordance with their methodologies.

- Where DNOs have departed from unadjusted settlement data for close out (including in restatement submissions), as part of the audit process we assessed that data for consistency with both written methodologies and reporting practice. Where a DNO in practice made certain adjustments during DPCR4, these formed part of its audited and approved reports to the Authority. The audit therefore proceeded on the basis that such adjustments were permitted. In our view, it is appropriate to rely on the interpretation of the methodology that was accepted during DPCR4, in the form of the audited annual return.

2.22. Regarding UKPN's estimate for future units, we have used the best data available relating to the energy that flowed during DPCR4 at the time of the data request (included in the July 2013 document) rather than selecting an arbitrary cut-off point. During the audit process we limited the data in UKPN's original proposal to a prudent level.¹⁴

2.23. UKPN's historical reporting included units relating to revenue protection services. We have permitted UKPN to include some data on revenue protection units in DPCR4 relating to activities in future years. We accept UKPN's explanation that it continued its revenue protection activities into the current price control period (DPCR5).

2.24. Revenue protection is a service provided for under industry codes. We consider that this activity is therefore likely to continue throughout the DPCR5 period. To reflect this we consider it appropriate to allow UKPN to include a prudent estimate of those units yet to be found for the remainder of DPCR5 but relating to energy flowing during DPCR4. We cannot say with any degree of certainty whether this activity will remain beyond DPCR5 and we have therefore not allowed any units forecast to be found through this activity beyond DPCR5.

Statistical robustness

Our decisions

2.25. The statistical test is the initial test for abnormality in reconciliation levels for 2009-10 and post 2009-10 data. We stand by decisions that we made that the statistical testing process and approach to restatement are appropriate for this purpose. We stand by our decision that the statistical testing of reported equivalent data following the 'SF adjustment' is the most appropriate way to test for abnormality.¹⁵ We reached these conclusions in light of independent expert input on

¹⁴ More details are available in our independent auditors' report:

<https://www.ofgem.gov.uk/ofgem-publications/84155/agclean20131025espfollow-upauditreportfinal.pdf>

¹⁵ SF is the initial settlement run. The SF adjustment is designed to estimate the size of post-SF reconciliations, taking into account any abnormality at SF.

both the data and the most appropriate statistical techniques to be used, alongside extensive stakeholder engagement.

2.26. We stand by our decision that the restatement process followed by each of the DNOs is in line with the stipulated approach, Approach C.¹⁶

Summary of our consultation position

2.27. Our October 2013 consultation set out our assessment of the DNOs' submissions in line with the decisions we had made earlier in this process, culminating in the July 2013 document. These included decisions on the statistical testing process and the precise use of Approach C under the restatement methodology (the 'SP methodology'). In our October consultation, we also suggested that DNOs may use cumulative sum (CUSUM)¹⁷ analysis and other techniques to help support their case for abnormality for years where this is not identified by the stipulated statistical test.

Consultation responses

2.28. One respondent raised a number of concerns with the statistical robustness of the restatement process. It repeated earlier concerns about the SF adjustment being applied prior to testing for abnormality. It considered that DNOs should be required to test for abnormality in 2009-10 on the basis of fully-reconciled data that has not been subject to the SF adjustment.

2.29. The same respondent also provided some analysis to suggest that CUSUM charts displaying falling reconciliation levels are likely to be driven by falling demand and are therefore not helpful for identifying abnormal levels of data cleansing. In addition, the respondent questioned UKPN's approach to restatement, noting that it removes non-settlement units prior to testing for abnormality, adding these back at the end of the process.

2.30. Another respondent raised concerns that there are too few data points for the statistical test. It also said suppliers had not been forthcoming in providing additional evidence of data cleansing in response to its requests.

Our response to issues raised

¹⁶ The restatement approach that addresses the need to reflect the energy that actually flowed during DPCR4 and the effects of abnormal data cleansing. Appendix 3 of the July 2013 document presents more detail on Approach C.

¹⁷ CUSUM charts display the magnitude of settlement reconciliations (in terms of units of energy) over time, on a cumulative basis. Such charts can be used to show the overall trend in the underlying data and any spikes or abnormalities away from the trend.

2.31. In the July 2013 document we cited CUSUM as a statistical technique that may be used in the additional evidence for abnormality, but we are not relying on this in isolation in our assessment. While we note the respondent's helpful analysis, we make the following points in response:

- The analysis is based on a simple assumption (acknowledged by the respondent) that estimated annual consumption levels (EACs)¹⁸ are updated with new meter reads on an annual basis. It does so by assuming that demand in one month will form the basis of an EAC (and hence SF run) in 12 months' time. In reality, the updating of EACs follows a far less predictable pattern.
- It assumes that all demand changes will flow through SF reconciliations subsequent to the demand change. In reality an estimate of weather and the change in customer numbers through new EACs will already be adjusted for in the SF runs that follow the demand change.
- All other things being equal, with falling demand fully-reconciled losses should also have decreased over the period. On the contrary, the data shows an increase in fully-reconciled losses relative to the start of DPCR4 period for all but one of the DNOs permitted to restate. This indicates that demand changes cannot be the sole driver of increasing negative reconciliation levels.
- While it is incomplete, evidence from suppliers shows an increase in data cleansing towards the end of the period, peaking with a net reduction of energy in settlement of over 550 gigawatt-hours (GWh) performed in 2009-10.
- Aside from the statistical test, we have not relied solely on a single source of evidence in assessing the applications. If the DNOs elected to use this analysis, the CUSUM charts were only intended to contribute to the overall evidence. In the event, only one DNO, Northern Powergrid (NPg), made limited use of the CUSUM analysis to support its application for additional abnormality.

2.32. The analysis presented is, however, helpful in drawing out an alternative contributory factor for negative reconciliations, namely falling demand. We explore this potential factor further in our assessment of evidence of additional abnormality later in this chapter. The analysis presented by this respondent is helpful without fundamentally undermining the statistical test, which we continue to stand by as the principal evidence for abnormality.

2.33. We have acknowledged the potential shortcomings of the statistical test, which (despite these shortcomings) we still consider to be the most pragmatic and robust test based on the limitations of the data. We amended the test following independent expert advice and continue to consider that the SF adjustment is necessary prior to testing for abnormality and is consistent with the intent of the SP

¹⁸ EACs are used to estimate electricity consumption for a given meter since the last time that meter was read.

methodology. The statistical test only measures the effects of data cleansing on reconciliations from the SF position. Abnormal levels of data cleansing affect the SF position as well and the SF adjustment recognises this.

2.34. The relatively low power of the test means that abnormality is less likely to be identified and therefore we have more confidence that any abnormality that it detects is real and does not simply result from changes in demand.

2.35. However, due to the test's low power, we invited DNOs that failed the statistical test to provide other evidence to support their case for abnormality. To assist in this process, we requested – and published where provided – data from suppliers and sought further comment from stakeholders on this evidence. Our analysis of this evidence is considered further later in this chapter. This additional evidence demonstrates that data cleansing activity will have contributed to the increasingly negative reconciliations during DPCR4, which, as stated above, is not separately accounted for in the respondent's analysis.

2.36. We consider that the restatement approaches followed by each of the DNOs are in line with the stipulated approach, Approach C. We have sought consistency across DNOs while taking into account their individual methodologies.

2.37. Under Approach C, DNOs test for abnormality, following the SF adjustment, on the basis of reported data. We decided on this approach in our July 2013 document following a period of extensive consultation. We stated that we consider that Approach C most closely aligns with the intent of Final Proposals by starting with the DNOs' historical reporting methodology approach before reconciling. We do not consider that testing fully-reconciled data without the SF adjustment is appropriate for identifying the effects of any abnormal levels of data cleansing. As stated above, we do not consider that the issues raised by responses to our October consultation indicate a need to reconsider this decision.

2.38. With respect to UKPN, we consider that its approach to restatement for close out is appropriate given its methodology and brings it more into line with other DNOs that report non-settlement units in addition to settlement data. UKPN's approach has changed since the November 2012 consultation as a result of discussions with us which aimed to ensure its approach was consistent with the intent of Approach C.

Credibility cap

Our decision

2.39. We have decided that a DNO's restated loss percentage will be capped at the **higher** of the two thresholds:

- Six per cent less than the target losses percentage.¹⁹
- Six per cent less than the overall (weighted) losses percentage over 2006-07 and 2007-08 on a fully-reconciled basis.²⁰

2.40. Based on this strengthened cap that further limits consumers' exposure, we have decided that the cap should not apply to a DNO applying for restatement if its un-restated losses are lower than its capped losses. To do otherwise could result in a perverse outcome, whereby a DNO's legitimate restatement submission reduces its losses, only to be financially penalised by the application of the cap.

Summary of our consultation position

2.41. Our July 2013 document set out our proposed credibility criteria to be used where a licensee's restatement application identifies abnormality in 2009-10 but the consequent restated performance is not credible. We stated that 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.

2.42. In the July 2013 document we proposed that a restated loss percentage would be capped if it is below **both** of the following thresholds:

- Five per cent less than the target losses percentage. This was based on the principle that the target losses 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. This was to help to limit exposure of consumers to outcomes from the application of the SP methodology.

2.43. In our October 2013 consultation we sought views on the application of this credibility cap in the restatement process. We also sought 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.

Consultation responses

2.44. We received a number of detailed responses on this issue. One respondent supported the proposed credibility cap while several offered alternative approaches. Some respondents raised general concerns about the potential for perceptions of

¹⁹ The target should be that used in the close out calculation.

²⁰ Fully-reconciled means to the same level of reconciliation used historically by the DNO during DPCR4.

leniency to DNOs should the capping be based on the lower of the two thresholds. This is because an outcome that fails to meet one of the tests for credibility may still be permitted if it is not lower than the second credibility threshold. To address these concerns they suggested using either just one credibility criterion or the higher of the two thresholds.

2.45. Two respondents considered that the credibility cap should be based solely on the normal period losses. They argued that, should the target threshold be retained, then the percentage should be increased to 10 per cent or 12 per cent. The 10 per cent suggestion reflects the expectation of progress in reducing losses in the time elapsed since the target setting period, while 12 per cent below the target reflects the performance of SSE: Southern Electric Power Distribution (SSES), which did not apply for restatement. One of these respondents added that a tighter cap would represent significant movement into retrospective regulation and would need further consultation.

2.46. Another respondent considered that the credibility cap need not be the same for all DNOs. It cited SSES's outperformance of 12 per cent, suggesting that this should help inform the target threshold. It noted that this level of outperformance is also the level of the upper quartile performance across DNOs in the years immediately preceding DPCR4 Final Proposals (published November 2004).

2.47. The same respondent considered that the normal period threshold should be changed to 2005-06 and 2006-07 (without the five per cent reduction) as these years are not affected by abnormal data cleansing. It considered that its proposals would avoid discriminating against those DNOs whose 2007-08 fully-reconciled data was affected by the abnormal data cleansing during 2009-10. In its response to the publication of the additional supplier data it stated that the evidence demonstrates that its licensees were materially affected by abnormal data cleansing in 2007-08 on a fully-reconciled basis. On the basis of its proposed revised thresholds it considered that the higher of the two thresholds may be appropriate.

2.48. One respondent stated that the cap should be based on the target only. Failing that, it proposed a cap based on either the target or the normal period, not both. It considered the cap to be unfair and inequitable where the normal period is not normal.

2.49. One respondent presented analysis suggesting the credibility criteria have been softened between what we said in July 2012 and those in the July 2013 document. Its analysis was based on a strict application of the July 2013 credibility criteria to the cap calculation as proposed in July 2012. (The cap calculation for July 2012 did not contain explicit credibility thresholds.) The respondent also raised concerns with the credibility of the restatement methodology given the difference between the capped and uncapped restatement outcomes.

2.50. This respondent considered that the target threshold should be adjusted to less than five per cent below the target (closer to zero per cent) and the normal

period threshold should be removed. Failing that, it considered that the cap should be based on the higher of the two thresholds.

Reasons for our decision

2.51. We have designed the credibility cap to ensure that consumers' exposure is limited 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. The cap is intended to limit the exposure to these risks while retaining the intent of the mechanism (and the regulatory settlement that it reflects). The credibility cap is a means of ensuring the reasonableness of the outcome for all stakeholders in light of the level of approximation involved.

2.52. As demonstrated by the reduction in the overall rewards since the November 2012 consultation, the credibility capping in the October 2013 consultation represents a stricter credibility check on losses levels. We note the concerns raised by stakeholders regarding capping at the lower of the two thresholds. Based on these concerns we now consider that the credibility cap should be based on the higher of the two thresholds. We agree that capping below one of the thresholds could undermine the effectiveness and logic of the capping process. We continue to consider that both thresholds provide a necessary check on the reasonableness of the outcomes, as explained below.

2.53. For each threshold, the six per cent has been rounded to the nearest percentage point from the figure derived in our analysis. We consider that to use more precise percentages would imply a level of accuracy inconsistent with the natural volatility of the data used to derive the figures.

2.54. Those DNOs not applying for restatement are not subject to the credibility cap. This is because we are only applying a cap to check that restated losses (ie the estimate in the absence of reliable data) are reasonable. Those not applying for restatement are following the close out process as set out in DPCR5 Final Proposals without any adjustments.

2.55. Our decision means that the credibility cap is stronger than that proposed at the time we invited DNOs to submit restatement applications (July 2013). We acknowledge that DNOs will have submitted restatement submissions at that time, on the basis of identifying that they have been adversely affected by abnormal levels of data cleansing. Such submissions would have reduced their reported losses, even after the application of the then proposed cap.

2.56. We have previously stated, regarding the impact of the annual incentive on the growth term, that a DNO should not be financially penalised through capping in comparison with its un-restated position. This was to ensure that, 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.

2.57. We have decided that this principle should be applied equally to the close out position. To do otherwise could result in a perverse outcome, whereby a DNO's legitimate restatement submission (following the stipulated methodology) increases its units distributed, only to be financially penalised by the application of the cap.

2.58. We have noted that, with the strengthened cap, for one licensee (UKPN's London Power Networks (LPN)), its capped losses will be at a higher level than its un-restated losses. As stated above, DNOs that are closing out on the basis of un-restated losses are not subject to the cap. We have never compelled DNOs to apply for restatement. They can reasonably be expected to have done so where they considered they have a legitimate case to restate their losses positions by replacing these with an estimate of the positions in the absence of abnormal levels of data cleansing.

2.59. To ensure equal treatment, if a DNO's un-restated losses are lower than its capped losses, its un-restated losses will be used for close out (giving the same effect as if it were permitted to withdraw its application for restatement). Therefore, LPN will be closed out based on its un-restated position. This is the basis of the calculation of the final PPL terms.

The target threshold

2.60. We continue to consider that a threshold based on the target is a necessary check on credibility as it represents long-term losses levels against which DNOs were measured during DPCR4, with a symmetrical incentive above and below that target.

2.61. In light of responses to the consultation, we have re-examined the appropriate threshold with respect to the target. We acknowledge the concerns that the target setting period includes losses performance relating to a period more than ten years before the 2009-10 performance. In response, we have focused on the losses performance for the three years from 2001-02 to 2003-04. We have selected this period because:

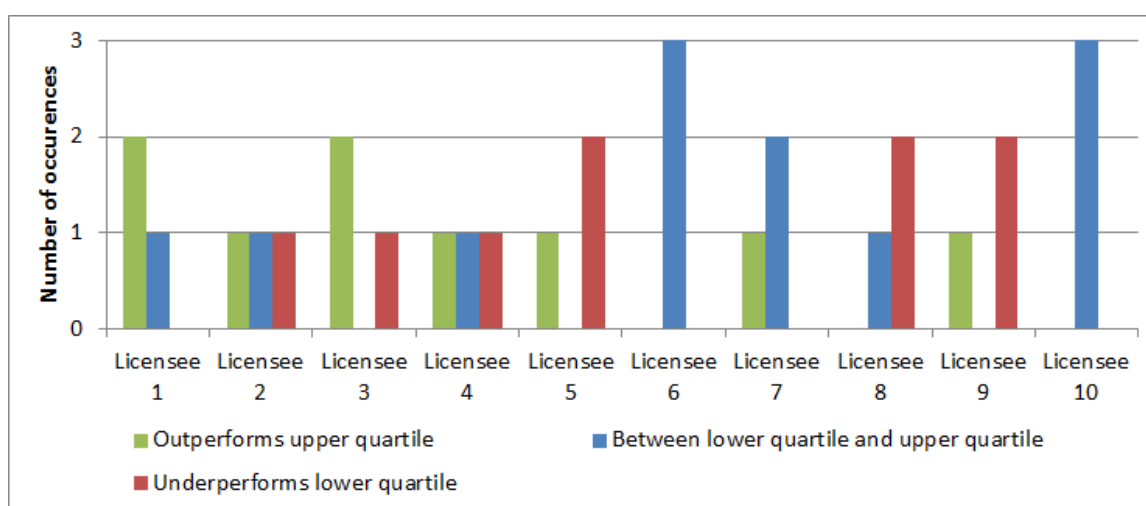
- It contains the years that will have informed reasonable losses levels for the DPCR4 price control of which stakeholders will have been aware at the time the targets were set.
- It excludes 2004-05, a year (a) that was not included in the target setting and (b) for which performance would not have been confirmed ahead of DPCR4 Final Proposals (November 2004) so would not have informed expectations of future performance at that stage.
- It includes two years for which DNOs must have reported on a methodology consistent with that during the DPCR4 period (2002-03 onwards).

2.62. In conducting this analysis we have also excluded the performance of the SSE and Scottish Power (SP) licensees. This is because, unlike for the other DNOs, SSE's performance for target setting was not based on settlement data. We have excluded

SP as our 2005 investigation into the regulatory submissions relating to 2001-02 to 2003-04 for SP raised fundamental questions which led to its targets for DPCR4 being reduced by a number of percentage points.²¹

2.63. We have analysed DNOs' performance in these three years against their DPCR4 targets. This has revealed some volatility. For instance, no DNO was able to sustain upper quartile performance for all three years, with some DNOs moving between upper and lower quartile performance in consecutive years, as demonstrated in Figure 1 below.

Figure 1 – Performance against DPCR4 target for 2001-02 to 2003-04 for all DNOs excluding the SP and SSE licensees



2.64. Figure 1 displays the distribution in performance for each DNO in each year relative to its DPCR4 target, categorised with respect to the upper and lower quartiles and the inter-quartile range. The quartiles are based on the performance for the ten licensees relative to their own DPCR4 targets. The quartiles for each year and the period overall are shown in the table below.

Table 1 – Overall performance against DPCR4 targets excluding SP and SSE

	2001-02	2002-03	2003-04	Overall
Lower quartile	0.2%	-3.4%	-5.4%	-2.0%
Median	-2.3%	-10.9%	-6.5%	-6.2%
Upper quartile	-13.2%	-12.5%	-12.5%	-12.9%

²¹ More details can be found here: <https://www.ofgem.gov.uk/publications-and-updates/electricity-distribution-allowed-loss-percentages-representation-scottishpower-energynetworks?docid=345&refer=Networks/ElecDist/PriceCtrls/DPCR4>

2.65. On the basis of this analysis we consider that the target threshold should not be based on upper quartile performance during this period, as suggested by one respondent. Given the known volatility in the data we do not consider that upper quartile performance as a credibility cap for all DNOs would be reasonable.

2.66. Given the range of outcomes between DNOs for the three years in question, we consider that the median performance of six per cent below the target is appropriate for this threshold of the credibility cap.

The normal period threshold

2.67. The normal period serves three purposes. First, it is used to apply the SF adjustment to 2008-09 and 2009-10 data, prior to abnormality testing, consistent with the restatement methodology. Second, it is used in the application of the restatement methodology to 'normalise' years found to have been affected by abnormal levels of data cleansing (2009-10 to 2012-13 as applicable). Third, it is used, on a fully-reconciled basis, to derive one of the thresholds for the credibility cap. It is this third application that we consider in this section.

2.68. Although we have considered a credibility cap solely based on the target, we have concerns that this will not be relevant for some licensees. This is because some licensees have consistently underperformed against their respective targets throughout the DPCR4 period. A cap based solely on the target would not be an effective measure of credibility in such cases. This is because it could lead to rewards for estimated performance that would be historically exceptional for that DNO, which could arise due to the underlying volatility of the data and approximation involved in the restatement process.

2.69. Some DNOs supported the proposal to base one threshold on five per cent below the fully-reconciled normal period performance. In contrast, two other DNOs raised concerns that the normal period would be affected by the abnormal data cleansing in 2009-10. This is because the normal period, based on fully-reconciled data, will include settlement reconciliation runs processed during 2009-10, most notably the DF runs, which occur up to 28 months after the energy has flowed through the system.

2.70. We have examined this concern and acknowledge that we should take this into account when setting the normal period threshold level. However, we disagree with one respondent's assertion that the normal period threshold should be based on the 2005-06 and 2006-07 losses. This is because the 2005-06 losses generally were far lower than those exhibited for the remainder of the DPCR4 period and we do not consider that use of that year would result in a robust credibility check that ensures reasonable outcomes.

2.71. In conducting our analysis of the appropriate level of the threshold related to the normal period, we have taken into account the timing of DPCR5 Final Proposals (December 2009), which was when the process for closing out the DPCR4 losses incentive mechanism was finalised and agreed. We consider that the data available

at that time will have informed stakeholders' expectations of a reasonable outcome of the incentive.

2.72. In December 2009, DNOs will have had full view of losses during the normal period (2006-07 and 2007-08) reconciled to the RF run. Reconciliations at RF affecting the normal period will predominately have happened before 2009-10, the year known to have been affected by abnormal levels of data cleansing.

2.73. We acknowledge that, at the time of DPCR5 Final Proposals, DNOs will have been unaware of the fully-reconciled DF losses for the normal period and the potential consequences for 2009-10 losses levels. It is clear from our analysis of reconciled data in the normal period that losses at DF were lower than those at RF for DNOs applying for restatement, partly as a consequence of the 2009-10 data cleansing.

2.74. For the majority of DNOs that reported on the basis of DF, the losses position in the normal period did not reduce by more than six per cent relative to RF. For the majority of DNOs, fully-reconciled losses in the normal period will have been no more than six per cent lower than the DNOs would have known at the time the close out calculation was finalised. The exceptions are those DNOs where the target is the higher of the two thresholds for capping. This is summarised in the table below.

Table 2 – The difference between DF and RF losses in the normal period and the impact of the normal period threshold on capping

DNO	Percentage DF losses in normal period below RF losses	Higher threshold
ENWL	0.00%	Target
NPgN	-4.42%	Normal
NPgY	-6.19%	Target
WMID	-1.61%	Normal
EMID	-6.47%	Normal
SWEST	-4.45%	Target
EPN	-12.74%	Target
LPN	-6.07%	Target
SPN	-6.78%	Target
SPD	-0.58%	Normal
SPMW	-2.31%	Normal

2.75. Based on the information available at the time of DPCR5 Final Proposals, losses performance in the stipulated normal period less six per cent would have informed projected performance based on data that was largely unaffected by abnormal levels of 2009-10 data cleansing.

2.76. We consider that this revised threshold upholds the original intent of the normal period threshold. That intent is to provide a credibility check on the basis of the normal period (that is used to derive restated losses) unaffected by abnormal levels of data cleansing. Based on the analysis above, we consider that the threshold of six per cent below the normal period losses performance is a reasonable way to limit consumers' exposure.

Normal period

Our decision

2.77. We have decided that all restatement applications will be processed on the basis of the previously stipulated normal period of 2006-07 and 2007-08.

Summary of our consultation position

2.78. In our July document we stipulated a normal period to enable DNOs to submit restatement applications. Following responses to that decision, our October 2013 consultation invited views on whether any particular DNO should be able to seek an alternative normal period by providing strong evidence to support the selection of a different normal period for that DNO, while still meeting the overarching principles. Those principles were that any normal period chosen falls within the DPCR4 period and does not include historically low, one-off, losses levels. We also sought views on what may constitute robust evidence for this purpose.

2.79. WPD's original submission for its East Midlands licensee (EMID) included an application on the basis of a normal period of 2005-06 and 2006-07. During the consultation, we published an additional submission from WPD for EMID presenting two other alternative normal periods (January 2006 to December 2007 and February 2006 to January 2008).

Consultation responses

2.80. One respondent presented analysis identifying the reported losses under restatement Approach C for each year from 2005-06 to 2008-09 for each DNO. Its analysis highlighted where these losses were below the credibility cap or above the reciprocal cap. It contended that, for seven of the eleven DNOs applying for restatement, the normal period losses are below the proposed credibility cap. It considered this is contrary to one of our policies for restatement: that the normal period should not contain non-credible losses.

2.81. We received some comments on the principle of an alternative normal period for restatement. Two stakeholders opposed allowing an alternative normal period, while three supported the idea in principle. One DNO stated that the selection of the normal period should be driven by reconciliation levels rather than losses levels. Two DNOs added that Ofgem stipulating a common normal period removes the risk of allegations of DNOs 'cherry-picking'.

2.82. Some DNOs were concerned that, if an alternative normal is permitted for one DNO this should be extended to all DNOs for reasons of equity. One respondent said that the common normal period is inappropriate for most DNOs and that the normal period selection should be dictated by credible losses levels.

2.83. EMID was the only DNO to submit a restatement application based on alternative normal periods. Its original submission was based on an alternative normal period of 2005-06 and 2006-07 supported by some evidence from suppliers of data cleansing taking place during our stipulated normal period. Its supplementary submission included evidence to support two potential alternative normal periods for which the weighted-average losses were just above and just below its target losses level. The analysis compared reconciliation levels in EMID with other DNOs applying for restatement and concluded that EMID was affected more than any other DNO by reconciliation levels during the stipulated normal period.

2.84. Overall, the three stakeholders that commented on EMID's supplementary application were critical of its analysis. One respondent said that its analysis demonstrates that the stipulated normal period is more appropriate for EMID than the alternatives proposed (in terms of credible losses levels). In its response to the additional supplier data, this respondent stated that this data does not support EMID's case for an alternative normal period.

2.85. Another respondent identified shortcomings in WPD's analysis, including the absence of statistical techniques such as CUSUM and failing to take into account the size of the DNO when comparing reconciliation levels. It concluded that other DNOs have at least as strong a case for an alternative normal period as EMID. One respondent noted that WPD had cherry-picked a normal period that is most likely to give it the outcome that it is seeking, that is to zero out the overall incentives under the mechanism for that licensee.

Reasons for our decision

Credibility of the stipulated normal period

2.86. It is worth clarifying that for the normal period, reconciliation levels are more important than losses levels. This is because the restatement methodology is based on a combination of losses at SF and reconciliation levels post-SF. We are satisfied that the reconciliation levels in the common normal period are suitable for the restatement process for all DNOs. Examining the losses levels (that they do not contain historically low, one-off losses levels) is a helpful additional check on the suitability of any alternative normal period proposed. The credibility cap, which we are strengthening, offers an additional safeguard against unreasonable outcomes from the restatement process as it is this that dictates the overall incentive level.

2.87. The approach to the normal period is the result of an extensive process and our final position is consistent with our published policies. The July 2013 decision consolidated and replaced previous guidance and stipulated a common normal period

based on our analysis of reconciliation levels (and therefore was not expressly related to credibility of losses levels).

2.88. In our October 2013 consultation we allowed DNOs to suggest alternative normal periods, if justified, and specifically referred to not including historically low, one-off losses levels in the alternative normal period. This was to provide an additional check if we were to allow any DNO to depart from the common normal period. We consider the common normal period is credible for all DNOs. We did not intend that the Approach C data, based on reported losses, be checked against the credibility criteria that relate to fully-reconciled losses for close out. Again, the credibility cap provides ultimate assurance of the credibility and reasonableness of the final outcome.

Alternative normal periods

2.89. We consider that an alternative normal period is acceptable in principle, provided it is based on strong evidence and in line with our two overarching principles (that it (i) falls within the DPCR4 period and (ii) does not include historically low, one-off, losses levels).

2.90. None of the evidence presented supports an alternative normal period for any of the DNOs. The EMID evidence does not present a strong case and other DNOs have not presented their own specific cases in response to the consultation.

2.91. We reject EMID's first proposal to base an alternative normal period on 2005-06 and 2006-07 because 2005-06 contains historically low, one-off, losses (3.4 per cent compared with a target of 5.7 per cent). Furthermore, the reconciliation levels in 2005-06 are an outlier compared with the remainder of DPCR4.

2.92. We also agree with one respondent that the second set of alternatives proposed by EMID appear to be driven by its desired outcome (for restated performance at or near the target losses) rather than being based on reconciliation levels. EMID's analysis of the inappropriateness of the common normal period was based on reconciliation levels whereas its proposed alternatives were based on losses levels.

2.93. The additional evidence provided by EMID did show that supplier-led data cleansing took place during the normal period. However, its analysis does not demonstrate, nor indeed refer to, the extent to which the data cleansing levels may be considered abnormal rendering the normal period inappropriate. Furthermore, the evidence of data cleansing does not appear commensurate with the levels of negative reconciliations, suggesting other factors, such as demand reduction, may help explain the patterns shown.

2.94. EMID's additional evidence relies on comparing its absolute reconciliation levels with those of other DNOs. When we normalise the analysis to remove the effects of the size of the DNO, we find that EMID was not uniquely affected by

negative reconciliation levels during the stipulated normal period. Four other DNOs applying for restatement using the stipulated normal period are affected to a similar extent compared with reconciliation levels across the DPCR4 period.

2.95. EMID provided no evidence that the reconciliation levels are in anyway exceptional or abnormal in the stipulated normal period. Its submission of alternative normal periods does not demonstrate that reconciliation levels in the alternative periods are more typical (or 'normal') of the DPCR4 period as a whole. (Indeed, our analysis suggests that the opposite is true.) Furthermore, EMID did not refer to possible other factors that may have contributed to negative reconciliation levels early in DPCR4, such as falling levels of demand.

2.96. We consider that EMID has failed to provide strong evidence to support using an alternative normal period.

2.97. No other DNO made a restatement submission on the basis of an alternative normal period, though some have indicated their intention to do so should others be permitted. We have not been presented with any strong evidence that an alternative normal period for restatement for any DNO is appropriate.

Other evidence for abnormality

Our decisions

2.98. We stand by our decision to consider other evidence for abnormality in 2009-10 submitted by DNOs that do not pass the statistical test for that year.

2.99. We have now decided to also consider other evidence for additional abnormality in post 2009-10 years submitted by DNOs where they do not pass the statistical test for those years.

2.100. In making our decisions on the submissions we have looked at data cleansing records from suppliers and checked losses levels against the 'reciprocal cap', alongside other evidence submitted by the DNOs.

2.101. We introduced the 'reciprocal cap' as a threshold with which to compare un-restated losses. We have decided that un-restated losses above the reciprocal cap will only contribute to the case for restatement rather than be used as a limit on the level of losses used for calculating the incentive.

2.102. For abnormality in 2009-10, we have decided that, where a DNO presents some additional evidence of abnormality and its fully-reconciled losses are above the reciprocal cap, it should be permitted to restate its losses performance in 2009-10. We have decided that where fully-reconciled losses for 2009-10 do not exceed the reciprocal cap licensees may only be permitted restatement where the additional evidence presents a coherent message of abnormality affecting 2009-10. That is,

each piece of additional evidence should reinforce that a given year was unusually affected compared with other, 'normal' years.

2.103. For abnormality in post 2009-10 years, we have decided that a licensee may only be permitted restatement of those years where the additional evidence presents a consistent message of abnormality affecting those years. That is, each piece of additional evidence should reinforce that a given year was unusually affected compared with other, 'normal' years. Comparison of reported-equivalent losses against the reciprocal cap is one piece of evidence used in our assessment.

2.104. In assessing the submissions for post 2009-10 years we have considered all of the evidence, highlighting any inconsistencies and then making a judgement on the overall weight of evidence. This is a finely balanced judgement. We have based our assessment of the evidence on the principle that the different pieces of evidence should be consistent in identifying the relevant post 2009-10 years as outliers relative to pre 2009-10 years. In setting a high bar for the strength of the evidence required we are protecting the interests of consumers.

2.105. We have decided that the reciprocal cap should be changed in line with the credibility cap, ie the **lower** of:

- six per cent more than the target losses percentage²²
- six per cent more than the overall (weighted) losses percentage over 2006-07 and 2007-08 on a fully-reconciled basis.²³

2.106. We have accepted restatement of the WPD West Midlands (WMID) and EMID licensees on the basis of abnormality in 2009-10.

2.107. We have not accepted the additional evidence of abnormality for years beyond 2009-10 for all relevant applicants (the NPg Northeast (NPgN) and Yorkshire (NPgY) licensees, WMID and EMID).

Summary of our consultation position

2.108. In our July 2013 document we said that we were considering applying a credibility check to ensure that the DNOs are not unfairly treated in the restatement process. This would apply where a DNO does not pass the abnormality test for 2009-10 but provides some other evidence to demonstrate it has been affected by abnormal levels of data cleansing activity.

²² The target should be that used in the close out calculation.

²³ Fully-reconciled means to the same level of reconciliation used historically by the DNO during DPCR4.

2.109. In our July 2013 document we said that DNOs could make a case for abnormality in 2009-10 should the statistical test not identify abnormality for that year. In light of responses to that document, our October 2013 consultation sought views on allowing additional evidence to support abnormality for post 2009-10 years, ie to treat them consistently with 2009-10.

2.110. In the consultation we said that we could not see an obvious reason to treat post 2009-10 years differently from 2009-10. While identifying abnormality in (and therefore normalising) 2009-10 remains crucial for the restatement process, the identification of abnormality (and normalisation) of post 2009-10 years on a reported basis can also have 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 in the close out process.

2.111. The consultation also asked whether the reciprocal cap can help identify abnormality (used alongside other evidence) should the statistical test not find those years to be abnormal. The proposed thresholds of the reciprocal cap were reciprocal to those of the credibility cap, ie the higher of:

- five per cent above the target
- five per cent above the normal period losses.

2.112. These reciprocal cap thresholds were to be used as supplementary to additional evidence for abnormality, not instead of it.

2.113. We clarified that, for 2009-10, 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.

2.114. For post 2009-10 years, we sought views on the use of 'reported equivalent' data²⁴ for comparison with the reciprocal thresholds. While fully-reconciled losses for post 2009-10 years are inconsequential for the close out process, data reported in these years reconciled back into 2009-10 affects the outcome and this is the principle behind restatement Approach C.

2.115. NPg and WPD provided additional evidence for abnormality in their restatement submissions that were published alongside our October consultation.

²⁴ Given that DNOs stopped reporting at the end of DPCR4, such 'reported equivalent' data should be based on the data collated for post 2009-10 years for the restatement applications.

Northern Powergrid

2.116. The two NPg licensees used reported data in their restatement applications. Both NPgN and NPgY identified abnormality in 2009-10 using the statistical test, while NPgN also identified 2011-12 to be abnormal. NPg provided additional evidence to support abnormality for all post 2009-10 years and applied for restatement on this basis. The evidence for both licensees included:

- the SF adjustment applied to years beyond the stipulated years of 2008-09 and 2009-10
- the pattern of losses over time showing a change towards the end of DPCR4
- the statistical test applied by calendar years
- evidence provided by suppliers that GVC continued beyond 2009-10
- explanation of the enduring effects of GVC on settlement data.

Western Power Distribution

2.117. As regards WPD, 2009-10 is not identified as abnormal by the statistical test for either EMID or WMID. In our July document we said that we would consider additional evidence where abnormality for 2009-10 was not identified in the test.

2.118. For these two licensees, WPD provided additional evidence to support abnormality in 2009-10 and in 2010-11. This evidence, published alongside the consultation, included:

- 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 to 2009-10 compared with earlier periods
- evidence that maximum demand has reduced in all of its licence areas over the DPCR4 period.

Additional evidence of data cleansing

2.119. Following a suggestion at a losses workshop in November 2013 we requested evidence from suppliers on levels of data cleansing activity over the DPCR4 period and up to March 2013. Though not all suppliers were able to provide comprehensive evidence, we published the collated data on 9 January 2014. We sought additional responses on this data to help analyse the cases made by NPg and WPD for abnormality where this is not identified in the statistical test for certain years. The responses to this additional evidence are considered below alongside responses to the October consultation.

Consultation responses

2.120. We received consultation responses concerning: the principle of allowing additional evidence, the use of the reciprocal caps and the specific evidence provided by the DNOs in question.

2.121. Five DNOs supported allowing additional evidence to help demonstrate abnormality in post 2009-10 years, while one respondent considered this provides additional leniency to the DNOs going beyond that in the July 2013 decisions.

2.122. With respect to the use of the reciprocal cap for triggering restatement for 2009-10 and post 2009-10 years, three DNOs supported this use, while two stakeholders disagreed with the proposal. One respondent considered that the reciprocal cap represents an even-handed extension to reflect the enduring effect on data cleansing on later years. Another respondent added that the reciprocal cap should only have one threshold. It added that rather than leading to restatement, the reciprocal cap should represent the level of 2009-10 losses for calculating the incentive.

2.123. One respondent considered that the reciprocal caps are inappropriate because they are based on absolute losses levels rather than reconciliation levels, which are the basis of the abnormality test. Another respondent did not accept that the use of reciprocal caps is valid unless the non-credible losses are removed from the normal period.

2.124. In response to the October consultation we received limited comment on additional evidence provided by WPD and NPg, covered below.

Additional evidence of data cleansing

2.125. Following publication of the additional evidence of supplier-led data cleansing we received responses from five stakeholders. Four of the five expressed serious reservations over the usefulness of the data from suppliers, while the other respondent analysed the data to support its case for restatement of post 2009-10 years, covered below.

2.126. Three DNOs expressed reservations with the use made of the data, highlighting that the pattern presented by the data (showing suppliers adding energy to settlement) was inconsistent with their own evidence and experiences. They suggested that only a comprehensive, fully-audited data set would be useful. One supplier also suggested that the data is not useful and that, at face value, it suggests that all applications for restatement should be rejected.

2.127. The few detailed responses with respect to the specific DNOs are considered below.

Northern Powergrid

2.128. In its consultation response NPg stated that, as the effect of supplier behaviour will continue to flow into settlement, there should be a presumption that post 2009-10 years will require restatement to ensure consistency with the 'behavioural standard' that prevailed when the price control was set. Moreover, it considered that its application provides compelling evidence that a change in supplier behaviour continued to affect post 2009-10 data.

2.129. NPg presented some additional analysis based on the evidence of supplier data cleansing that we published. It considered that the data proves unequivocally that a change in supplier settlements activity took place, and that this will have a material impact on losses. It also stated that a significant direct impact of GVC is seen on data reported in 2009-10 and 2010-11, with smaller effects during 2011-12 and 2012-13. It added that the corrections activity will have had a lasting impact on other aspects of the settlement process.

2.130. After the end of the deadline for responses to the additional data, NPg re-submitted a more accurate way of apportioning the impact of the data cleansing activity on its reported data.²⁵ In this additional submission it applied the statistical test to the data cleansing evidence to demonstrate that 2009-10 and subsequent years were outliers in terms of levels of data cleansing.

2.131. One respondent rejected NPg's claims on the basis that its normal period losses (for both licensees) are below the credibility threshold. It considered that permitting normalisation of further years would add to rewards that have not been justified.

2.132. This respondent also provided analysis of the additional data relating to NPg. It acknowledged the negative reconciliations for NPg licensees for 2009-10 on a reported basis but noted that these turn positive for subsequent years. It also stated that the evidence shows net additions by suppliers to settlement for the NPg licensees in 2009-10 on a fully-reconciled basis.

Western Power Distribution

2.133. In response to the October consultation, WPD stated that post 2009-10 data should be adjusted where: the DNO provides factual evidence that applies in particular years or where a DNO's losses are so high that they exceed the reciprocal cap. It added that post 2009-10 years should be adjusted as they will have contributed to the cap being exceeded.

²⁵ We have published NPg's additional submission alongside this decision.

2.134. In response to the October consultation one stakeholder stated that for EMID the pattern of reconciliations is consistent with what it was expecting during DPCR4. The respondent suggested that the WMID and EMID licensees have gained an unfair advantage from the use of provision accounts during DPCR4 reporting. It was not opposed to WMID's restatement on the basis of abnormality in 2009-10 only. It added that accepting abnormality for further years for either licensee would add to overall rewards (including DPCR3 units) and is not justified.

2.135. Overall, no stakeholders opposed WMID being permitted restatement for 2009-10 only, which was the consultation position under the 'vanilla assessment'.

2.136. WPD considered that no reliance should be placed on the additional supplier evidence until a comprehensive and fully-audited data set is available. There were no additional comments on WPD's specific case in response to the publication of the additional supplier evidence.

Reasons for our decisions

2.137. We note the concerns over the additional supplier evidence of data cleansing. Alongside our independent auditors, we have examined this data and are seriously concerned about the data provided by one supplier. This data accounts for almost 99 per cent of the c.630,000 records and swamps the effect of the remaining data. This data shows net energy being added to settlement by that supplier, which is inconsistent with other records from the impact of data cleansing at that time. Furthermore, it is inconsistent with earlier data provided to WPD by that supplier, a difference for which the supplier has not provided an adequate explanation. In analysing the supplier evidence we have therefore placed more weight on the data provided by other suppliers, but have only used it alongside other sources of evidence.

2.138. Some respondents have requested that we collect a comprehensive record of supplier data and subject this to a full audit equivalent to that for the DNOs' close out data. We would like to stress that the data available was provided after a series of requests, culminating in a formal information request under Standard Licence Condition 5 of the Electricity Supply Licence. We do not consider therefore that any additional retrievable data could be provided in a timely manner. And given that the data will be incomplete, we do not consider that auditing it would be worthwhile. We are only using this data to contribute to our assessment of additional abnormality, not as providing a definitive answer in itself.

2.139. We consider that the reciprocal cap should be amended in line with the credibility cap. We consider that this sets the credibility test at a fair level to limit the exposure of DNOs, while also protecting consumers.

Abnormality for 2009-10

2.140. We stand by our position, set out in our July document and October consultation, that DNOs should be able to make a case for restatement of 2009-10 data in the absence of identifying abnormality for this year in the statistical test. In assessing each case, comparing fully-reconciled un-restated data for 2009-10 with the reciprocal cap is instructive in limiting DNOs' exposure to the close out process. This is because, in the absence of restatement, the fully-reconciled losses for 2009-10 dictate the overall incentive. If the licensee provides some evidence of abnormality affecting 2009-10 and the reciprocal cap is exceeded for this year then that licensee should be permitted restatement of 2009-10 data.

2.141. We disagree with the assertion that the reciprocal cap should be used as the final losses level rather than contribute to the evidence for restatement. This is because, up until restatement is permitted, DNOs are following DPCR5 Final Proposals in an unadjusted way, based on fully-reconciled losses data. We do not intend to impose a cap on losses calculated on the basis of unadjusted fully-reconciled data.

2.142. We are only applying a cap where losses have been restated to estimate their true level in the absence of abnormal levels of data cleansing. Exceeding the reciprocal cap may be used to trigger this restatement process. The credibility cap then operates as a check on restated losses irrespective of whether the restatement process is triggered by passing the statistical test or on the strength of other evidence of abnormality.

2.143. WPD provided some evidence for abnormality in 2009-10 for both WMID and EMID. While some of the evidence it provided is irrelevant for this purpose, the relevant data supports 2009-10 as being the outlier in terms of evidence of data cleansing and levels of negative reconciliations. WPD also added evidence for why the statistical test will not be so reliable in its case: because negative reconciliations began earlier in these areas compared with other DNOs. This was one of the reasons why we considered that the statistical test may not fully reflect the extent of abnormality affecting some DNOs. There are differences in the evidence presented between the two licensees.

2.144. For WMID:

- There is some evidence of data cleansing affecting 2009-10 more than other years. Records show data cleansing conducted in 2009-10 removed around 8 GWh from settlement, around four times that in 2010-11.
- While 2009-10 is not identified as abnormal under the statistical test, 2009-10 reconciliations are the clear outlier for the DPCR4 period, with 2010-11 reconciliation levels back to those of the normal period (2006-07 and 2007-08).
- WMID's un-restated fully-reconciled losses for 2009-10 exceed the reciprocal cap.

2.145. WMID has provided some evidence that it was affected by abnormality in 2009-10 and its fully-reconciled losses exceed the reciprocal cap for that year. On that basis we have decided that WMID should be permitted restatement for 2009-10.

2.146. For EMID:

- The evidence of data cleansing is focused on 2009-10. Records show data cleansing conducted in 2009-10 removed around 28 GWh from settlement, around three times the level in 2008-09, and also more than in 2010-11.
- Its un-restated fully-reconciled losses are marginally below the threshold of the reciprocal cap (6.00 per cent losses compared with a lower reciprocal cap threshold of 6.03 per cent). The data cleansing evidence shows 21 GWh of net negative corrections in 2009-10 on a fully-reconciled basis.
- While 2009-10 is not identified as abnormal under the statistical test, reconciliation levels show 2009-10 to be a clear outlier relative to all other years.

2.147. While it is not possible to disaggregate the impact of demand changes on reconciliation levels, we consider there is a consistent message from the additional evidence that, for EMID, 2009-10 was affected by unusually high levels of data cleansing relative to other years. On the balance of evidence we have decided that EMID should be permitted restatement for 2009-10.

Abnormality for post 2009-10

2.148. We consider that there is a case for allowing abnormality for post 2009-10 years, but this must be sufficiently well-justified. On reflection, and in light of consultation responses, we have concerns about comparing the reciprocal cap with 'reported-equivalent' data for post 2009-10 years.

2.149. Our principal concern is that this reciprocal cap neither relates directly to reconciliation levels (which is the key evidence for abnormal data cleansing) nor does it directly relate to the overall outcome in the absence of restatement (unlike fully-reconciled losses for 2009-10).²⁶ Furthermore, despite the limited power of the test, other DNOs have demonstrated abnormality for post 2009-10 years, which reinforces our belief that the test is suitable as the principal method for identifying abnormality. For these reasons, we have placed less weight on the reciprocal cap when assessing abnormality for post 2009-10 years.

²⁶ 2009-10 un-restated fully-reconciled data dictates the outcome in the absence of restatement. In contrast, for post 2009-10 reported equivalent un-restated data, only those reconciliation runs that relate to 2009-10 on a fully-reconciled basis will influence the final close out position.

2.150. In assessing the submissions for post 2009-10 years we have considered all of the evidence, highlighting any inconsistencies and then making a judgement on the overall weight of evidence. This is a finely balanced judgement. We have based our assessment of the evidence on the principle that the different pieces of evidence should be consistent in identifying the relevant post 2009-10 years as outliers relative to pre 2009-10 years.

Northern Powergrid

2.151. NPg provided some other evidence of abnormality for post 2009-10 years that generally supports 2009-10 as the worst affected year. In the case for post 2009-10 abnormality we have found inconsistency across the evidence.

2.152. For NPgN:

- The supplier evidence shows data cleansing activity undertaken in 2009-10 affecting NPgN to be a clear outlier with around 124 GWh of energy removed from settlements compared with less than 0.2 GWh in each of the three subsequent years. Even when NPg estimated a re-apportionment of this activity data to when this data cleansing will have been recorded in its reporting methodology, 2009-10 is still a clear outlier with the levels in 2010-11 reduced by more than three-quarters relative to that year.
- NPg's amendments to the statistical test included extending the SF adjustment to post 2009-10 years and conducting the test on a calendar-year rather than regulatory-year basis. These amendments, beyond the scope of our stipulated methodology, showed all post 2009-10 years to be abnormal for NPgN. However, we consider that 2009-10 remains a clear outlier for negative reconciliations in comparison with all other years.
- NPgN also applied the statistical test to the data cleansing evidence. This revealed 2009-10 and 2010-11 to be abnormally negative, with subsequent years abnormally positive. When it combined the data cleansing impact with its estimate of the abnormal level of SF for all post 2008-09 years, all years from 2009-10 onwards were found to be abnormally negative. We consider that given the incomplete nature of the data cleansing evidence this testing is not statistically robust, with the confidence intervals constructed around only two years' worth of (incomplete) data.
- NPgN's un-restated losses on a reported-equivalent basis are above the reciprocal cap for all post 2009-10 years. While post 2009-10 losses are above the pre-2009-10 level, 2009-10 losses are a clear outlier with losses dropping by 0.9 percentage points in 2010-11.

2.153. For NPgY:

- The supplier evidence shows data cleansing activity undertaken in 2009-10 affecting NPgY to be a clear outlier with around 357 GWh of energy removed

from settlements compared with less than 0.3 GWh in each of the three subsequent years. When NPg estimated a re-apportionment of this activity data to when this data cleansing will have been recorded in its reporting methodology, 2009-10 continues to experience the most negative reconciliations, but with 2010-11 also an outlier (at around 40 per cent of 2009-10 levels) in comparison with subsequent years.

- NPg's amendments to the statistical test included extending the SF adjustment to post 2009-10 years and conducting the test on a calendar-year rather than regulatory-year basis. These amendments, beyond the scope of our stipulated methodology, show all post 2009-10 years to be normal. It also applied the test with the confidence intervals narrowed to 85 per cent (compared with our stipulated 95 per cent level). Only under these conditions does the test find post 2009-10 years to be abnormal. 2009-10 remains a clear outlier in terms of negative reconciliations in comparison with all other years, with post 2009-10 reconciliations closer to 2007-08 levels (one of the years of the normal period) than to 2009-10 levels.
- NPgY applied the statistical test to the data cleansing evidence with the same results as for NPgN. Our concerns over the robustness of this analysis are the same as we describe for NPgN (above).
- NPgY's un-restated losses on a reported-equivalent basis are above the reciprocal cap for 2010-11 and 2012-13. However, again 2009-10 losses are a clear outlier with losses dropping by 0.7 percentage points in 2010-11.

2.154. NPg failed to explain the inconsistency between the different sources of evidence for both its licensees. While there is good supplementary evidence to support abnormality in 2009-10, a consistent case is not presented for post 2009-10 years for either licensee. We are also concerned that NPg's presentation of the evidence is not comprehensive. For example, it did not comment on the apparently net positive corrections made by suppliers to settlement data in 2009-10 on a fully-reconciled basis, while it used the same supplier data to support its case for post 2009-10 abnormality.

2.155. We consider that NPg has not presented a sufficiently strong case for additional abnormality for post 2009-10 years.

2.156. While the supplier evidence for NPgY shows significant data cleansing affecting 2010-11, we are not prepared to rely on a single piece of evidence in isolation to support additional abnormality. This is particularly so in the case of the supplier data that is known to be incomplete, with NPg the only stakeholder that has supported its use. NPg did not explain its initial estimated apportionment of the effects of data cleansing to 2010-11. Our examination of its submission revealed that the methodology overestimated the impacts on 2010-11. Its more reasonable estimate presents a significantly lower impact of data cleansing on 2010-11 reporting, albeit at an estimated 90 GWh it still could have had a potential impact on the losses incentive. Owing to the incomplete nature of the supplier evidence, this estimate presents a partial picture that is not consistent with the other evidence.

2.157. For NPgN, the amendments to the statistical test show that some post 2009-10 years failed the stipulated test by a relatively small margin. However, while reconciliation levels for 2011-12 are more negative than 2010-11, to the extent that 2011-12 is found to be abnormal in the statistical test, this is not supported by the data cleansing evidence. As such the evidence does not present a consistent picture for post 2009-10 abnormality.

2.158. In the absence of a consistent message from the evidence for post 2009-10 years we rely on the statistical test, with 2009-10 and 2011-12 being identified as abnormal for NPgN and only 2009-10 abnormal for NPgY. Setting a high bar for the strength of the evidence required protects the interests of consumers.

Western Power Distribution

2.159. WPD's evidence is focused on demonstrating abnormality in 2009-10 with limited reference to post 2009-10 years.

2.160. For WMID:

- Data cleansing undertaken in 2010-11 is around a quarter of the level for 2009-10. WMID did not attempt to re-apportion the impact of this data cleansing on its reported data.
- The statistical test shows 2010-11 reconciliations to be less negative than 2009-10 and back at normal period (2006-07 and 2007-08) levels.
- WMID's un-restated reported-equivalent losses for 2010-11 exceed the reciprocal cap but are at a lower level than 2009-10.

2.161. For EMID

- Data cleansing undertaken in 2010-11 is around 60 per cent of the level for 2009-10. EMID did not attempt to re-apportion the impact of this data cleansing on its reported data.
- The statistical test shows 2010-11 reconciliations to be less negative than 2009-10 and back at pre 2007-08 levels.
- EMID's un-restated reported-equivalent losses for 2010-11 exceed the reciprocal cap but are at a lower level than 2009-10.

2.162. WPD has failed to put together a strong case for restatement of 2010-11 for EMID and WMID and has not explained the inconsistent evidence. It has made only limited reference to abnormality in 2010-11.

2.163. For WMID, only one piece of evidence that we have analysed (reported-equivalent losses compared with the reciprocal cap) supports 2010-11 abnormality. For the reasons stated above, we have placed limited weight on this reciprocal cap.

2.164. As for WMID, EMID exceeds the reciprocal cap for 2010-11. EMID was also affected by relatively high levels of data cleansing conducted in 2010-11 compared with other years, though we have significant concerns with the accuracy of the data provided.

2.165. In the absence of a consistent message from the evidence for post 2009-10 years we rely on the statistical test, with no post 2009-10 years being identified as abnormal for WMID or EMID. Setting a high bar for the strength of the evidence required protects the interests of consumers.

Targets for the close out calculation and indexation of incentives received

Our decisions

2.166. We stand by our decision that the average target should be used for close out for DNOs with more than one target during DPCR4.

2.167. We also stand by our previous decisions that Retail Price Index (RPI) indexation should be used to inflate the value of incentives received to 2009-10 prices.

Summary of our consultation position

2.168. In our October 2013 consultation we said that for those DNOs with more than one target over the DPCR4 period, we will use an average of the targets for the purposes of the close out calculation.

2.169. Our 28 March 2012 consultation sought views on whether nominal or RPI-indexed values should be used for incentives already received over DPCR4. Overall respondents said that it was implicit in Final Proposals that the incentive rewards/penalties for earlier years would be adjusted using RPI-indexation to ensure that the close out calculation was not affected by differences in the relative values at the end of the price control period (2009-10).

2.170. Our November 2012 consultation clarified how we would apply an inflation indexation to the incentives already received over DPCR4. Our October 2013 consultation confirmed that approach and addressed one DNO's view that as DPCR5 Final Proposals did not refer to indexation of the incentives already received under this mechanism, none could be applied. We set out our reasons and that we propose to apply RPI indexation to adjust the value of incentives received to 2009-10 prices.

Consultation responses

2.171. One respondent questioned whether we were permitted to index the incentives already received. To support its position it cited views expressed in the RIIO-ED1²⁷ working group and the absence of the explicit reference to indexation when we updated the methodology document for closing out the DPCR4 incentives.²⁸ No other stakeholders commented on these two issues.

Our response to issues raised

2.172. We stand by our decision on the targets to be used in the close out calculation as stated in our October 2013 consultation. We will use the targets (known as the allowed loss percentage or "ALP") set out in Annex A to Special Condition C1 for all licensees unaffected by any interim target adjustment.

2.173. For the four licensees whose target value was changed during DPCR4, we will use the average ALP to calculate the close out values. The ALP_{DPCR4} values for the four affected licensees will be:

- Scottish & Southern Energy: Southern Electric Power Distribution: SSES - 6.68 per cent
- Electricity North West Limited (ENWL) – 5.56 per cent
- Scottish Power Energy Networks (SP):
 - Scottish Power Manweb (SPM) – 5.43 per cent
 - Scottish Power Distribution (SPD) – 5.40 per cent.

2.174. As stated in our October 2013 consultation, we consider that not applying indexation to the incentives already received would mean that loss reduction early in the period would receive higher reward than loss reduction later in the period. We do not consider that this is the intent of the mechanism. We consider that the silence on this point in DPCR5 Final Proposals does not indicate that indexation would not take place. We do not agree that this restricts our ability to apply indexation to the values. This decision in our view best upholds the intent of the close out calculation with respect to indexation of incentives received, in the absence of explicit provision on this matter.

²⁷ RIIO-ED1 is the next electricity distribution price control which will cover the period from 1 April 2015 until 31 March 2023.

²⁸ In January 2013 we re-published the methodology for closing out the DPCR4 losses incentive mechanism to remove interactions with the DPCR5 mechanism. This was in light of our decision not to activate the mechanism for DPCR5. See: <https://www.ofgem.gov.uk/ofgem-publications/45537/methodology-closing-out-dpcr4-losses.pdf>

2.175. We have considered how the RIIO-ED1 process treats inflation and the time value of money, as applied to different components of the price control. We do not consider that our approach in this case differs from the approach taken in RIIO-ED1 for similar type adjustments.

2.176. We calculate the close out value in common energy units, using the value of £48/MWh.²⁹ We have used RPI to index all values up to 2009-10 prices, the final year of the incentive. RPI indexation is used to inflate a value to a common year. Indexation beyond 2009-10 is covered in the next section.

Recovery

Our decisions

2.177. The PPL values have been calculated in 2009-10 prices. We have decided to inflate the PPL values to 2012-13 prices using RPI.³⁰ The final close out PPL values are directed in 2012-13 prices (which is the RIIO-ED1 price base), in the direction that accompanies this decision.

2.178. We have decided to smooth the recovery of the PPL values with 2015-16 as the first year of recovery.

2.179. The PPL values will be smoothed based on an annual cap of no more than three per cent of forecast Base Demand Revenue. We have calculated the value to be recovered each year (in 2012-13 prices) applying a cap of three per cent of the forecast Base Demand Revenue in 2015-16. Licensees will continue to recover or return funds up to this limit until all values are recovered or returned. In 2016-17 the value may be more than three per cent for DNOs whose prior provisional PPL recovery is reflected in the 2014-15 correction factor. We consider this is appropriate because (i) this will smooth the overall effect of recovery (ii) suppliers will have had adequate notification of this effect and (iii) this will avoid unnecessary delay to the close out.

2.180. The directed values will attract a time value of money adjustment using the Bank of England Base Rate plus a margin of 1.5 percentage points.

2.181. Any provisions a DNO may have already made in its charges to recover these values in previous years will be adjusted through the correction factor, which, in the neutral band, is subject to a time value of money adjustment using the Bank of England Base Rate plus a margin of 1.5 percentage points. There is no need to offset these amounts against the PPL values before directing the PPL value for each year of

²⁹ This was the losses incentive rate set in DPCR4 to reflect the wholesale value of electricity.

³⁰ Using the retail prices index term as defined in CRC2 of the electricity distribution licence.

recovery, or to apply any additional indexation adjustment, as the correction factor uses the same indexation as that applied to the PPL values.

2.182. We have taken the impact of the forecast correction factor into consideration when directing the spread of PPL value for 2016-17 due to the lag in the correction factor in RIIO-ED1. This reduces charging volatility and the period of PPL recovery in most cases. This approach is consistent with our prior position on this issue which stated that we intended to take into consideration prior PPL recovery by DNOs when determining the period over which PPL would be recovered.

2.183. We stand by our previous statement that any adverse impact or penalty arising as a result of the effect of the restatement of data or the anticipation of PPL values on a DNO's under/over recovery position, will be dealt with on a case-by-case basis (discussed further below).

Summary of our consultation position

2.184. We stated in our consultation that we had calculated the total value of the PPL having taken no account of any provision DNOs may already have made in recovering these values in charges in previous years. We said that we intended to take into account DNOs' PPL estimates for years prior to 2015-16. We stated that we would consider how the PPL term should be recovered, and requested any views on the appropriate period for recovery.

2.185. We also requested views on the way in which indexation and the weighted average cost of capital (WACC) should be applied when the close out values are recovered.

Consultation responses

2.186. Respondents generally considered that recovery should be over the shortest possible period, while limiting the impact on distribution use of system (DUoS) charges³¹ in any one year. Most respondents considered that a maximum of two to three years would be optimal, starting in 2015-16. There was also some consensus that, depending on the final PPL values, some smoothing is advisable and will allow suppliers to factor the impact into tariffs.

2.187. One respondent noted that final values should be adjusted for any amounts already recovered in DUoS charges and considers that any effect on consumers should be net present value (NPV) neutral. It suggested that if a PPL value is less than six per cent of base revenue, recovery should be split over two years, or over a maximum of three years if PPL value is over six per cent of base revenue. Another

³¹ DNOs recover the costs of running their networks by charging suppliers DUoS charges.

suggested a limit of three per cent of base revenue in each year, which may extend the number of years for full recovery.

2.188. A further respondent suggested a cap of £20 million (in 2009-10 prices) in any one year, but with a maximum recovery period of three years. This could in some cases mean more than £20 million in the third year, but suppliers would have had adequate notice of the impact.

2.189. One respondent suggested that it would be best to recover the full PPL value over one year in 2015-16, and that an early determination would give suppliers sufficient notice, but another respondent considered that a longer timeframe would be required to provide adequate time for any impact to be priced into tariffs.

2.190. Seven respondents addressed indexation, expressing a range of different views.

- One stated that RPI-based indexation should be applied from 2009-10 until 2012-13 (as this was the intended first year of recovery) and that RPI and WACC should be applied to recoveries post 2012-13, with some adjustment to pick up estimates of PPL recovery already made. Another stated that RPI-based indexation and that pre-tax WACC should be applied and should be applied to the lag between the amount being earned and impacting on revenue.
- One suggested that the total value should be NPV neutral, applying the DPCR5 WACC.
- Another suggested that the approach should be aligned with the RIIO-ED1 approach to deferred incentives for other mechanisms, and considered that a risk-free rate (Bank of England Base Rate) plus a margin should be applied. Another also considered that the PPL values should be stated in 2009-10 prices, and that any adjustments should be calculated in the same way as for other lagged incentives in DPCR5 and apply a Bank of England Base Rate.
- One considered that the approach should be consistent with that for other lagged incentives, and that only base rate indexation should apply, taking into account any interim amounts recovered in 2012-13 and 2013-14. It suggested a pragmatic solution setting the annual indexation value at 0.5 per cent and calculating the PPL terms in a one-off exercise, to provide clarity to the market.
- One did not consider that indexation could be applied. If it was, an approach consistent with that applied to other lagged incentives should be applied, using the Bank of England Base Rate.

Reasons for our decisions

2.191. We have considered a number of options for the recovery of the PPL. We have taken into account the views expressed by respondents, as well as the option of smoothing the recovery over the full RIIO-ED1 price control period.

2.192. We have considered the impact of the recovery on all stakeholders. An early recovery of the full amount is generally preferred in order to close out the DPCR4 losses mechanism as soon as practicable, bearing in mind that the original intention (in CRC7) was that the PPL term would be recovered from 2012-13 to 2014-15. We consider it to be an important principle that any delay in recovery is justified as being in the interests of stakeholders and, in particular, consumers.

2.193. We have also considered the potential impact on volatility and certainty of DUoS charges. We consider that our decision provides an appropriate balance between (i) recovering the PPL as soon as practical and (ii) limiting the impact on customers in any one year.

2.194. The PPL value was set to zero for the first two years of DPCR5 (2010-11 and 2011-12) through the licence. The first year that PPL was expected to impact on revenues was 2012-13. We therefore consider that RPI-indexation should be applied to the values until 2012-13, to take into account the impact of inflation.

2.195. From 2012-13 the Bank of England Base Rate plus a margin of 1.5 percentage points should be applied to the PPL values until recovery is complete. This approach is consistent with the approach applied to correction of over or under recoveries. We consider this is the appropriate time value of money adjustment (inclusive of inflation). Our reasoning takes into account that these amounts would (absent the restatement process and delay involved) have been recovered in earlier years and so are at least analogous to under or over recoveries.

2.196. This approach has the effect of treating all PPL recoveries in an equal manner, whether past or future. This approach does not penalise any DNO for the different approaches they have taken to addressing the delays in directing the final PPL close out values. Under existing mechanisms any forecast of PPL values included in a DNO's charges for 2012-13, 2013-14 or 2014-15 will be unwound through the over or under recovery of revenue and the correction factor.

2.197. We consider this equal treatment is a strong justification not to apply WACC plus RPI indexation, which we had previously considered. To do so would mean that PPL recoveries in anticipation of our final direction would incur a different rate of indexation to future PPL recovery. This would potentially penalise those DNOs who had retained the PPL forecasts previously included in their charging forecasts. Some suppliers had strongly resisted DNO's revising those forecasts once it became clear that we would not direct the PPL values in 2012-13. As a consequence some DNOs retained these amounts in their charges.

2.198. We considered this to be the most practical and equitable way to take into account PPL estimates for years prior to 2015-16 which some DNOs had included in their charges. Any such amounts a DNO may have included in forecast revenue will not have been reported against the PPL term in the DNOs' revenue returns, since no PPL value has been directed by the Authority. These amounts will have contributed to an over or under recovery revenue position, and will be carried forward in the correction factor. We do not expect DNOs to revise their 2014-15 charges as a result

of this decision although we are aware that this will affect the current under or over recovery position included in forecasts.

2.199. The impact of the 2014-15 correction factor will occur in 2016-17, as the RIIO-ED1 process introduces a lag for corrections. To counter the effect this lag could have on DNO revenues, our direction of PPL_t for 2016-17 (and subsequent years) takes these forecast corrections into account.

2.200. We stand by our previous statement that any adverse impact or penalty arising as a result of the effect on the growth term, or the anticipation of PPL values on a DNO's under/over-recovery position will be dealt with on a case-by-case basis.

2.201. Our October consultation noted that as a result of restatement of the 2009-10 data, a DNO's current position with regard to under or over recovery of revenue could change, which could have the effect of penalising the DNO under licence condition CRC 14 (Distributed Charges: supplementary restrictions). In response to a separate consultation on 10 May 2013³², some DNOs indicated that depending on the decisions 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. Our October consultation made it clear that we would consider any such application on its merits.

2.202. Further sections of licence condition CRC 14 also cover the treatment of charges in the event of over or under recovery, particularly where the licensee's Regulated Combined Distribution Network Revenue exceeds 105 per cent, or is less than 90 per cent, of its Combined Allowed Distribution Network revenue. We note that as a result of these decisions some DNOs' Regulated Combined Distribution Network Revenue could fall outside of these levels. We would consider whether any actions are necessary to mitigate this effect on the merits of each case.

Summary of assessment for close out

2.203. In the assessment that follows, a table compares the DNOs' submissions with our assessment based on the decisions in this document.

2.204. 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:

³² The decision not to activate the DPCR5 losses incentive mechanism meant that previous forecasts underlying the determination of charges were changed, aggravating ENWL's position of under recovery in 2012-13 beyond the point at which a restricted interest rate became applicable.

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

2.205. The tables present figures in 2009-10 values to aid comparison with the October 2013 consultation position. For LPN, as a result of the strengthened credibility cap, its un-restated units distributed are greater than the capped level. Therefore, its close out is based on its un-restated position. Appendix 1 includes additional charts for each DNO area and the overall position.

Table 3 – Summary of close out submissions compared with our final assessment

DNO	Assessment	Years normalised	Cap applied?	Losses (%)	5xE (£m)	PPL (£m)
ENWL	DNO submission	All		4.94%	43.2	0.5
	Decision	All	Yes	5.23%	23.2	-19.5
NPgN	DNO submission	All		4.85%	15.7	2.7
	Decision	2009-10; 2011-12	No	5.12%	3.5	-9.5
NPgY	DNO submission	All		5.00%	58.8	10.7
	Decision	2009-10	No	5.55%	23.0	-25.1
WMID	DNO submission	2009-10; 2010-11		5.31%	-24.4	-0.6
	Decision	2009-10	No	5.57%	-42.6	-18.8
EMID	DNO submission	2009-10; 2010-11		5.78%	-7.1	-70.1
	Decision	2009-10	No	5.84%	-11.6	-74.6
SWEST	DNO submission	2009-10; 2011-12		6.35%	25.6	-1.5
	Decision	2009-10; 2011-12	Yes	6.54%	17.4	-9.7
EPN	DNO submission	All		5.04%	128.8	19.5
	Decision	All	Yes	5.94%	38.0	-71.4
LPN	DNO submission	All		5.10%	121.5	52.7
	Decision	None	No	5.75%	66.5	-2.3
SPN	DNO submission	All		5.78%	47.8	14.5
	Decision	All	Yes	6.15%	24.6	-8.8
SPD	DNO submission	2009-10		5.96%	-32.6	12.6
	Decision	2009-10	No	5.96%	-32.6	12.6
SPMW	DNO submission	2009-10		6.16%	-34.4	4.9
	Decision	2009-10	No	6.16%	-34.4	4.9

Final PPL terms

2.206. This section contains the final PPL values for each DNO. To aid comparison with the October 2013 consultation position, the values presented here are in 2009-10 prices. 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 for prior years.

2.207. In the direction that accompanies this decision, we set out the PPL terms and the recovery period for each DNO, under CRC 7. That direction takes account of DNOs' PPL estimates for years prior to 2015-16. The figures have been inflated in line with the decisions on recovery set out earlier in this document.

2.208. Table 4 below, contains the final total values of the DPCR4 losses incentive mechanism (5xE) for reference.

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2.209. Table shows the final residual value of the incentive mechanism (PPL) to be recovered. For comparative purposes the tables also include the following positions: un-restated, the DNOs' submissions and the 'vanilla assessment' from our October 2013 consultation (based on the framework of the July 2013 document). The underlying data is available at Appendix 2.

Table 4 - 5xE values for reference (£m, 2009-10 prices)

DNO Group	DNO	Un-restated	DNO submission	Oct-13	Decision
ENWL	ENWL	-46.2	43.2	39.1	23.2
NPg	NPgN	-24.6	15.7	3.5	3.5
	NPgY	-23.2	58.8	20.5	23.0
WPD	WMID	-47.5	-24.4	-42.6	-42.6
	EMID	-24.3	-7.1	-24.3	-11.6
	SWALES	-10.4	-10.4	-10.4	-10.4
	SWEST	13.0	25.6	25.6	17.4
UKPN	EPN	-45.6	128.8	75.2	38.0
	LPN	66.5	121.5	84.8	66.5
	SPN	22.0	47.8	24.9	24.6
SP	SPD	-120.4	-32.6	-32.6	-32.6
	SPMW	-103.5	-34.4	-34.4	-34.4
SSE	SSES	66.7	66.7	66.7	66.7
	SSEH	24.5	24.5	24.5	24.5
Total		-253.0	423.8	220.5	155.8

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Table 5 – Final PPL terms to be recovered (£m, 2009-10 prices)

DNO Group	DNO	Un-restated	DNO submission	Oct-13	Decision
ENWL	ENWL	-88.9	0.5	-3.6	-19.5
NPg	NPgN	-37.6	2.7	-9.5	-9.5
	NPgY	-71.3	10.7	-27.7	-25.1
WPD	WMID	-23.7	-0.6	-18.8	-18.8
	EMID	-87.3	-70.1	-87.3	-74.6
	SWALES	-6.8	-6.8	-6.8	-6.8
	SWEST	-14.0	-1.5	-1.5	-9.7
UKPN	EPN	-155.0	19.5	-34.1	-71.4
	LPN	-2.3	52.7	16.0	-2.3
	SPN	-11.3	14.5	-8.4	-8.8
SP	SPD	-75.1	12.6	12.6	12.6
	SPMW	-64.2	4.9	4.9	4.9
SSE	SSES	46.0	46.0	46.0	46.0
	SSEH	22.0	22.0	22.0	22.0
Total		-569.6	107.2	-96.1	-160.8

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

Chapter Summary

This chapter contains our decisions related to DNOs' restatement submissions for the annual incentive. It considers responses to our October 2013 consultation and explains how we have reached our final decision. It contains the final impact of our decisions on the annual incentive for 2009-10.

The 2009-10 annual incentive and the growth term

3.1. 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).

Restatement for the annual incentive

Our decisions

3.2. We stand by our decision of the October 2013 consultation that we will continue to limit our consideration to the restatement of data for the annual incentive to 2009-10. This decision also means that we do not consider it appropriate to recalculate the growth term for years prior to 2009-10.

3.3. In submitting the data for the 2009-10 annual incentive and calculating the 2009-10 growth term, in line with our July 2013 decision, DNOs have submitted the corrected data for previous years, including removal of manifest errors and have submitted data on a basis consistent with their historical reporting.

Summary of our consultation position

3.4. Our October consultation set out our decision to limit consideration to the restatement of data for the annual incentive to 2009-10 and to recalculate the growth term for this year only.

3.5. The data submitted and the calculation of the impact on the growth term included corrections to manifest data errors uncovered through the audit process for all years of DPCR4. Our consultation set out the manifest errors identified through the audit process that had been corrected in DNOs' submissions.

Consultation responses

3.6. Respondents expressed support for the correction of manifest errors in previous years. One DNO considered it should also be allowed to restate 2008-09 considering that there is clear evidence that the growth term in that year was also distorted by data correction activity.

3.7. One respondent expressed disappointment that we are only considering restatement for the growth term in 2009-10. It stated that not recalculating the growth term in previous years where manifest errors in the data have been discovered is unduly lenient to the DNOs that will have benefitted from those errors in the growth term calculation for earlier years.

Reasons for our decisions

3.8. We stand by our decision that, on balance, there is not sufficient justification to undertake a further prolonged process of restatement of data for years prior to 2009-10. The responses we have received have not persuaded us to re-visit this decision given the factors we have previously highlighted, repeated below.


- 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 DPCR4 price control (published November 2004).
- 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.

Credibility cap

Our decisions

3.9. We have decided that the credibility cap for the annual incentive should be identical to that applied for close out. A DNO's restated loss percentage will be capped at the **higher** of the two thresholds:

- Six per cent less than the target losses percentage.



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

- Six per cent less than the overall (weighted) losses percentage over 2006-07 and 2007-08 on a fully-reconciled basis.

3.10. We have decided to apportion the total units distributed at different voltage levels based on the proportions at the different voltage levels reported in 2006-07 and 2007-08. This is consistent with our proposal in the July 2013 document.

3.11. We stand by our decision that a DNO should not be financially penalised through capping in comparison to its un-restated position. This is consistent with our position throughout the restatement process.

Summary of our consultation position

3.12. In our October consultation, the assessment of restatement applications was consistent with the framework from our July decision:

- that the credibility cap for the annual incentive be at the same level as that for the close out
- apportioning the total units distributed at different voltage levels based on the proportions at the different voltage levels reported in 2006-07 and 2007-08
- not financially penalising DNOs relative to the un-restated position through application of the credibility cap.

3.13. We published an assessment of the impact on the growth term based on the eight submissions from DNOs. We sought views on our assessment, including the application of the cap.

Consultation responses

3.14. Respondents were generally supportive of our assessment. The exception was the one DNO that stated that there is no logical reason for the cap for annual reporting to be the same as cap for close out. It considered that one threshold of the cap could be based on reported rather than fully-reconciled data given that the annual incentive is calculated on the basis of reported data.

Reasons for our decisions

3.15. We consider that the same cap should be applied to the annual incentive as is applied to the close out. We consider this approach is proportionate given the necessary estimate that results from restatement and the need for any outcome to be reasonable. If a losses level is unreasonable and subject to capping for close out it is equally inappropriate for the growth term.

3.16. We apportioned the total units distributed to different voltage levels based on the proportions at the different voltage levels reported in 2006-07 and 2007-08. Given that the restatement process results in an estimate of total units distributed, we consider the established normal period to be appropriate for apportioning those units to different voltage levels.

3.17. If the restatement process identifies that a DNO's units distributed for 2009-10 should be increased, then it should not be penalised financially for the way the cap is calculated.

Recovery

Our decisions

3.18. The total value left to recover in respect of the impact of restatement on the growth term has been calculated in 2009-10 prices. We do not consider it appropriate for DNOs to have to resubmit all revenue returns from 2009-10. However, we also do not consider that the methodology for setting the final PPL values allows for the growth term value to be taken into account. We have decided to consult separately on a licence change so that Allowed Revenue may be adjusted in an appropriate period to take account of the growth term impact.

3.19. We have decided that any delay between the year to which restated data relates and the adjustment taking effect should be subject to a time value of money adjustment applied in the price control period over which the delay has taken place. This means that the DPCR5 WACC plus RPI indexation will be applied from 2009-10 until 2015-16 and the equivalent values for RIIO-ED1 will be applied for any delay to recovery beyond 2015-16.

Summary of our consultation position

3.20. We sought views on our proposal that the final values for the growth term impact 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.

3.21. We also stated our view that any updates to 2009-10 data should be applied by means of updating the revenue returns for 2009-10, to ensure consistency with the interim decisions already made on data restatement.

Consultation responses

3.22. Six respondents expressed opinions for dealing with the impact on the growth term. Only one respondent considered that all revenue returns should be resubmitted.

3.23. Five respondents considered that the growth term restatement variance should be a one-off adjustment to a future year's Allowed Revenue subject to a time value of money adjustment, although they expressed different views on the appropriate adjustment.

3.24. One respondent considered that RPI indexation should be applied for each relevant year and that the pre-tax WACC should be applied in each year for the lag in impacting revenue. One respondent likened this issue to the RIIO-ED1 approach to deferred incentives for other mechanisms, suggesting that RPI indexation only should be applied.

3.25. Two respondents suggested an interest rate adjustment, using the Bank of England Base Rate plus a margin of 1.5 percentage points. One suggested that a base rate of 0.5 per cent each year could be used.

Reasons for our decisions

3.26. We consider that the most sensible and practical means of taking into account the impact of the data restatement on the growth term would be to make a one-off adjustment to a future year's Allowed Revenue, subject to a time value of money adjustment from 2009-10 until the year of recovery. We do not consider it practical or proportionate to require DNOs to resubmit all 2009-10 and subsequent revenue returns, as it would result in an unnecessary administrative burden and could have unintended consequences.

3.27. However, we also do not consider that the current methodology for finalising the PPL values allows for a one-off adjustment to be made to Allowed Revenue in any particular year to take account of the growth term impact. We therefore consider that it will be necessary to consult separately on an appropriate adjustment to be made to Allowed Revenue in respect of the growth term impact.

3.28. We consider that restatement of the 2009-10 revenue returns would result in changes to the Allowed Revenue and therefore attract a time value of money adjustment applied in the price control period over which the delay occurs. This is to emulate the effect had the figures for units distributed derived from this restatement process been included in the original 2009-10 revenue return. This has the effect of ensuring equal treatment with the DNOs subject to an interim restatement that previously re-submitted their revenue returns for 2009-10.³³

3.29. The DPCR5 WACC plus RPI indexation will be applied from 2009-10 until 2015-16. Should recovery be delayed beyond 2015-16, the RIIO-ED1 WACC plus RPI

³³ Two DNO groups Electricity North West Limited (ENWL) and NPg obtained interim restatement of their 2009-10 units distributed, prior to the further process.

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indexation will be applied for subsequent years. This is consistent with the treatment of other revenue driver values.

3.30. As stated previously, any penalty arising as a result of this decision will be dealt with on a case-by-case basis.

Summary of assessment and final growth term values

3.31. Table 6 below displays the DNOs' submissions against our assessment based on the decisions in this document. The position from our October 2013 consultation is also presented for comparative purposes.

3.32. 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.

3.33. The differences between the October consultation and the final position relate to the revised cap being applied to ENWL, NPgN, NPgY, EPN and LPN. The table shows that application of the credibility cap has significantly reduced the total impact of restatement of the annual incentive compared with DNOs' submissions.

Table 6 - Summary of financial impact of annual incentive submissions compared with our final assessment

DNO	Oct-13 (£m)	DNO submission (£m)	Final assessment (£m)
ENWL	0.57	0.57	0.40
NPgN	0.03	0.11	-0.03
NPgY	-0.43	0.12	-0.37
EPN	0.47	4.56	-0.26
LPN	-0.02	1.71	-0.37
SPN	-0.15	1.39	-0.15
SPD	0.28	0.28	0.28
SPMW	0.70	0.70	0.70
Total	1.46	9.44	0.21

Notes:

For ENWL, NPgN and NPgY, the change is relative to the interim restatement decisions recorded in 2009-10 revenue returns.

The positions for EPN, LPN and SPN are negative due to reinstating provisions for 2009-10 following the data audit.

4. 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.

4.1. The final PPL values for each DNO are set out in the direction that accompanies this decision. The direction includes the amounts, period for recovery and spread between each year for each DNO. It does so in line with the decisions of this document.

4.2. We have decided to consult separately on a licence change so that Allowed Revenue may be adjusted in an appropriate period to take account of the growth term impact.

4.3. We will deal with any adverse impact or penalty arising as a result of the effect on the growth term, or the anticipation of PPL values on a DNO's under/over-recovery position on a case-by-case basis.

Appendices

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Appendix 1 – Summary of final positions and updated impact assessment

A1.1 In our October 2013 consultation we included an impact assessment based on the different assessment outcomes upon which we consulted. This Appendix presents the impact of our decisions on each DNO. It also presents the aggregate position for the 11 DNOs that applied for restatement and for all DNOs. LPN, whose final outcome is based on un-restated data, is included in the analysis for the DNOs that applied for restatement. The data used to compile this analysis is published as Appendix 2 alongside this decision. All figures are presented in 2009-10 prices.

A1.2 For comparison with our final assessment, we present some alternative outcomes:

- 'Un-restated' is the position had we rejected all restatement
- 'DNO submission' is based on DNOs' applications in response to the July 2013 document before our assessment of additional evidence of abnormality or the application of the credibility cap
- 'Oct-13 vanilla assessment' is the October 2013 consultation position based on our assessment against the framework in the July 2013 document.

Table 7 – Aggregate PPL terms for DNOs

	Only DNOs applying for restatement	All DNOs
Un-restated	-£630.8m	-£569.6m
DNO submission	£45.9m	£107.2m
Oct-13 vanilla assessment	-£157.3m	-£96.1m
Final assessment	-£222.1m	-£160.8m

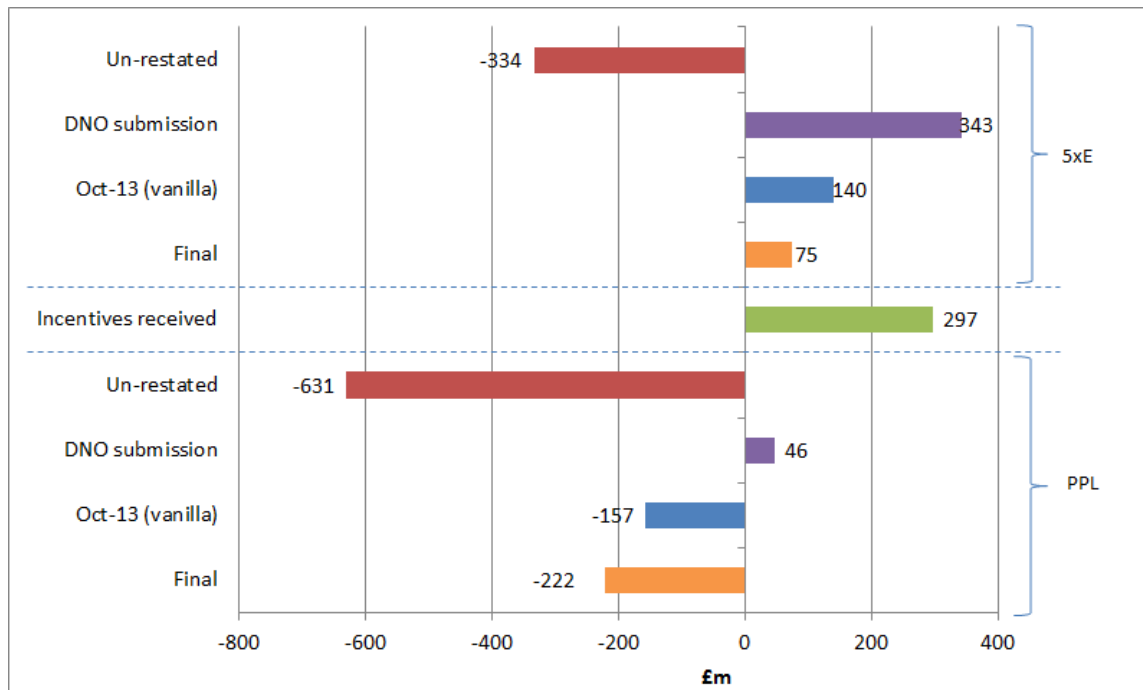
A1.3 The DNO submissions would result in a positive PPL for the DNOs, while our final assessment results in the DNOs returning money to customers.

A1.4 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.

Summary of Impact

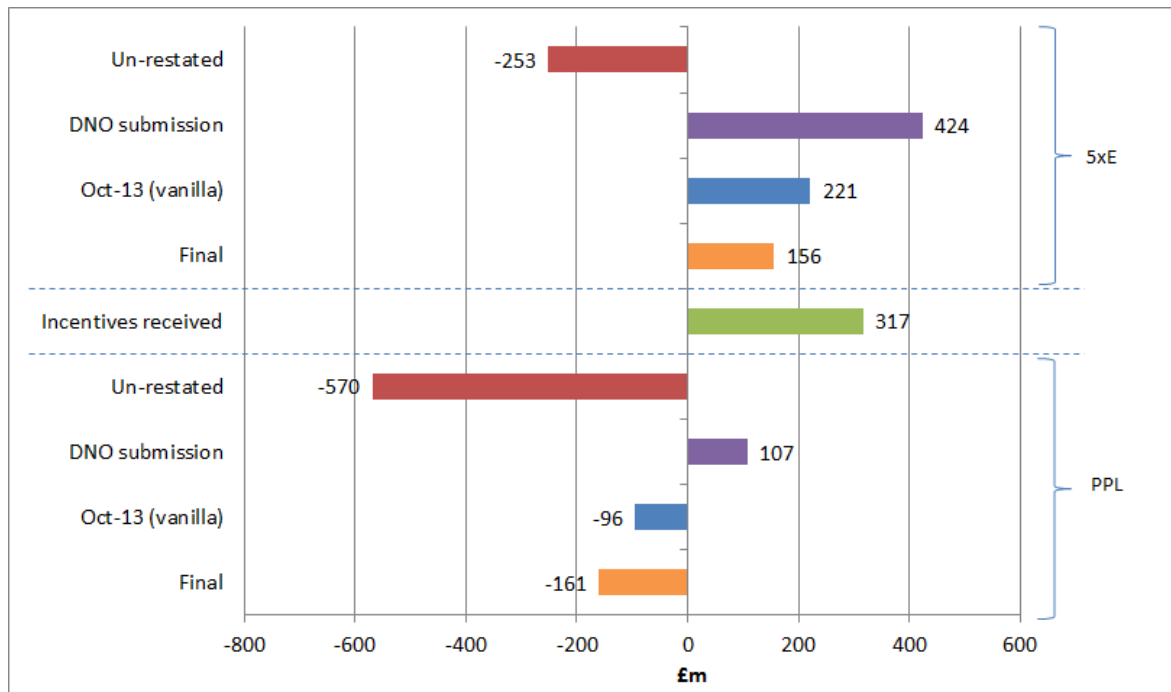
Impact on DNOs in aggregate

Figure 2 - DPCR4 losses outcomes for 11 DNOs applying for restatement



A1.5 Our final assessment represents the outcome where the aggregate value of the incentive is closest to zero of the outcomes presented.

Figure 3 - DPCR4 losses final outcome for all DNOs



A1.6 As a result of our decisions, on aggregate DNOs will be returning £161 million to customers.

Table 8 – PPL terms for DNO groups

£m	Un-restated	DNO submission	Oct-13 (vanilla)	Final
ENWL	-89	1	-4	-19
NPg	-109	13	-37	-35
WPD	-132	-79	-114	-110
UKPN	-169	87	-27	-82
SP	-139	18	18	18
SSE	68	68	68	68

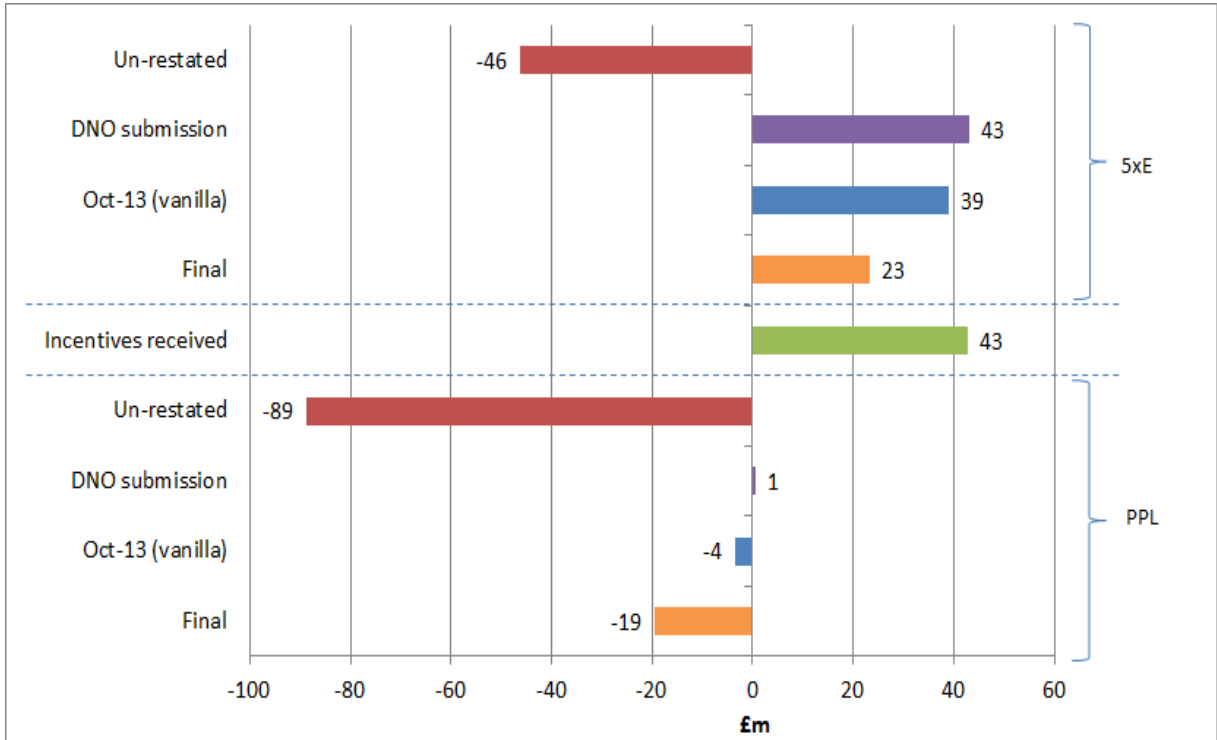
A1.7 As a result of our decisions WPD return the most money to customers, while the highest PPL is for SSE which has not applied for restatement.



Impacts on individual DNOs

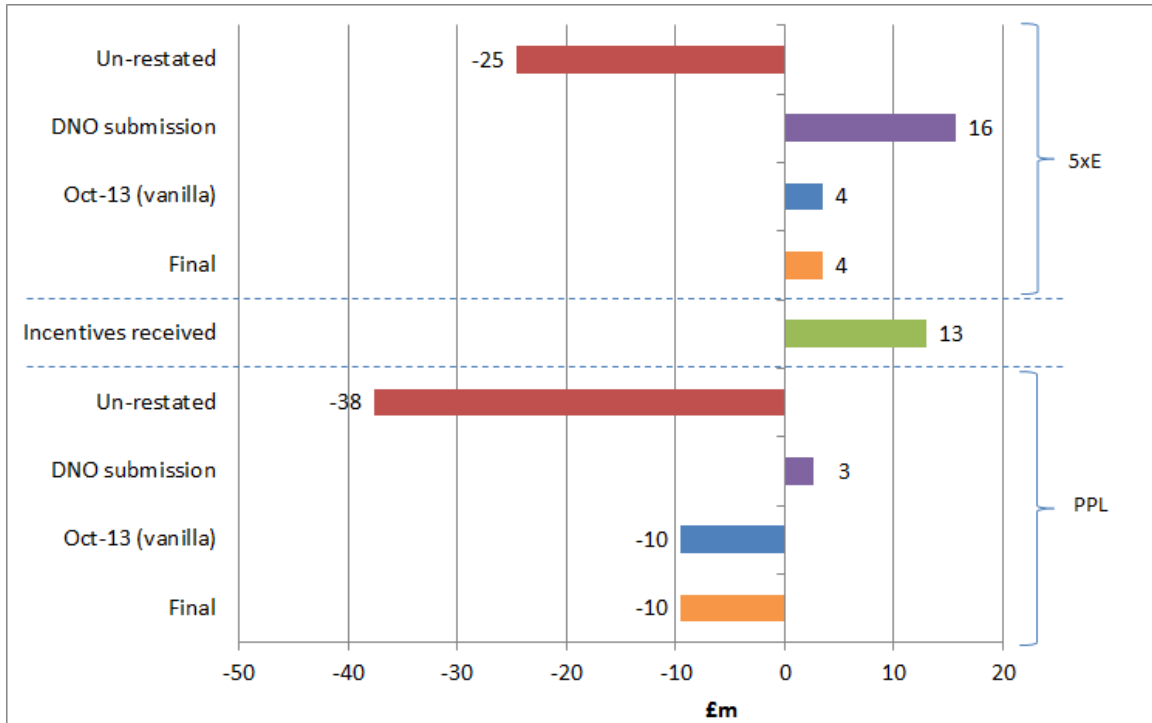
A1.8 The following charts display the overall outcomes under the DPCR4 losses incentive mechanism for each DNO.

Figure 4 – DPCR4 losses final outcome for ENWL



A1.9 Application of the strengthened credibility cap limits the overall rewards to ENWL by £20 million relative to its restatement submission.

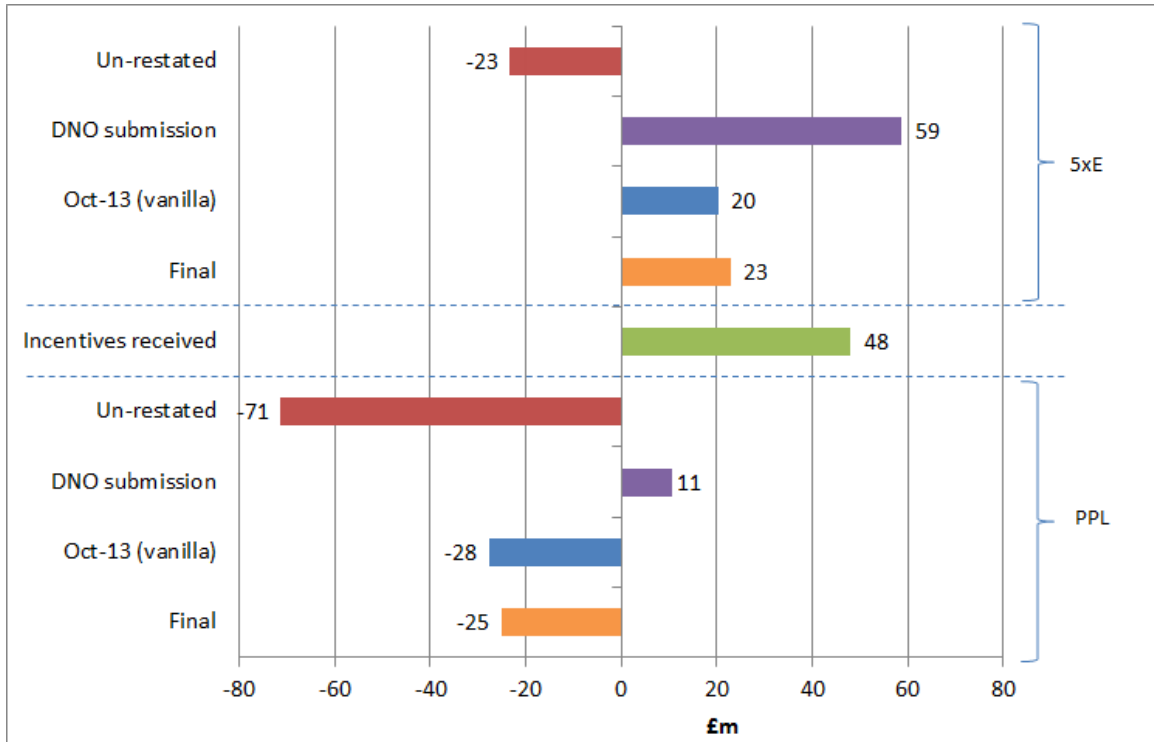
Figure 5 - DPCR4 losses final outcome for NPgN



A1.10 Our decision to reject NPgN’s additional evidence for post 2009-10 abnormality limits the overall rewards to NPgN by £12 million relative to its restatement submission.



Figure 6 - DPCR4 losses final outcome for NPgY

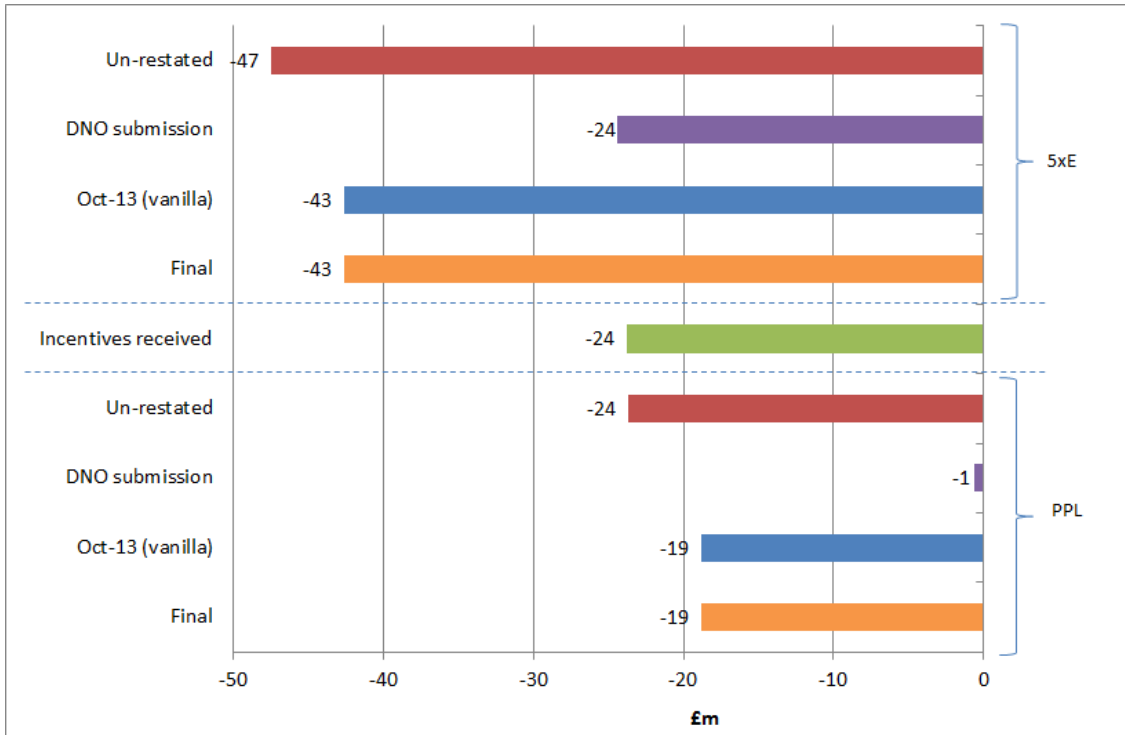


A1.11 Our decision to reject NPgY’s additional evidence for post 2009-10 abnormality limits the overall rewards to NPgY by £36 million relative to its restatement submission.



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

Figure 7 - DPCR4 losses final outcome for WMID

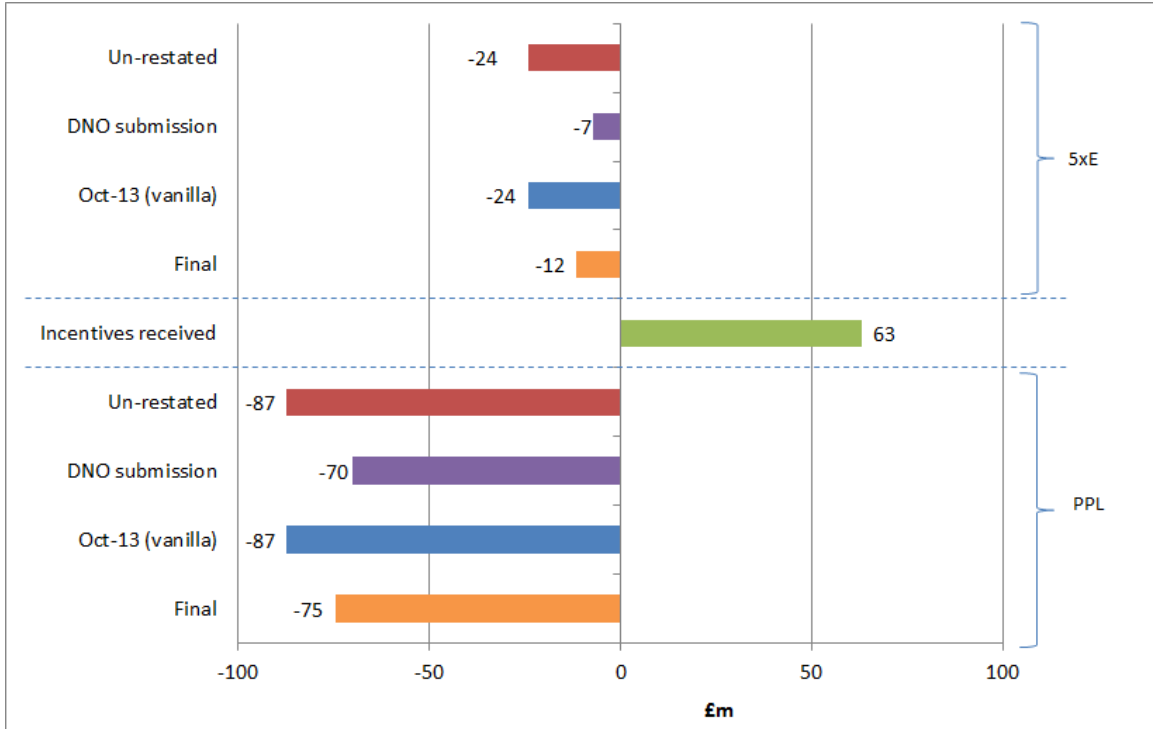


A1.12 Our decision to reject WMID's additional evidence for post 2009-10 abnormality limits the overall rewards to WMID by £19 million relative to its restatement submission.



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

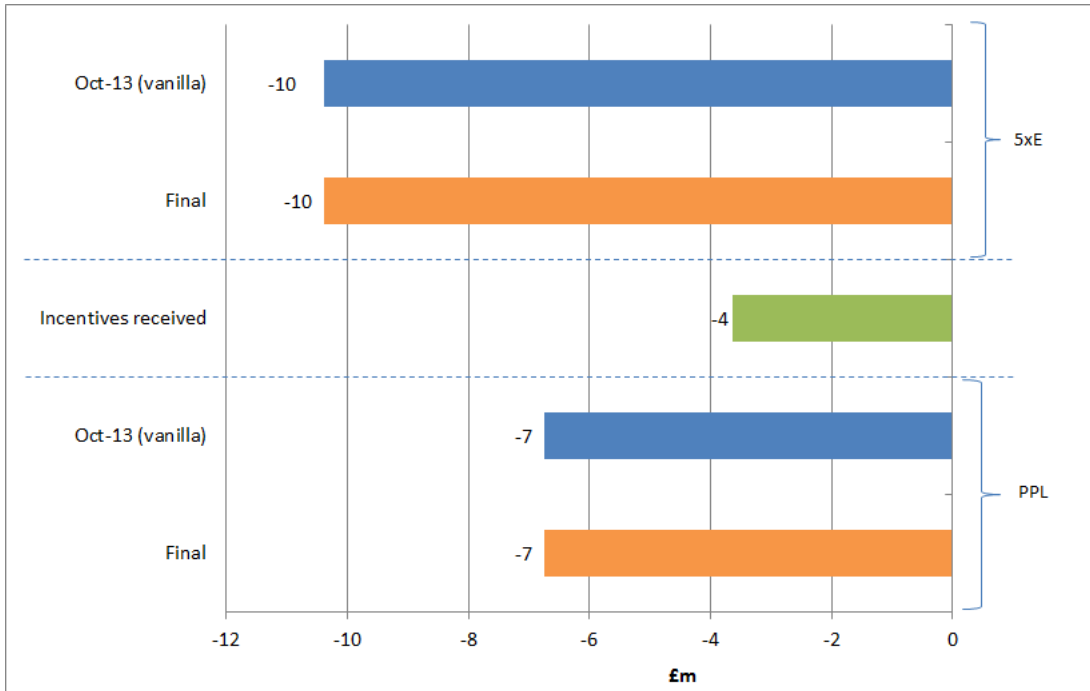
Figure 8 - DPCR4 losses final outcome for EMID



A1.13 Our decision to reject EMID’s additional evidence for post 2009-10 abnormality limits the overall rewards to EMID by £5 million relative to its restatement submission.



Figure 9 - DPCR4 losses final outcome for SWALES

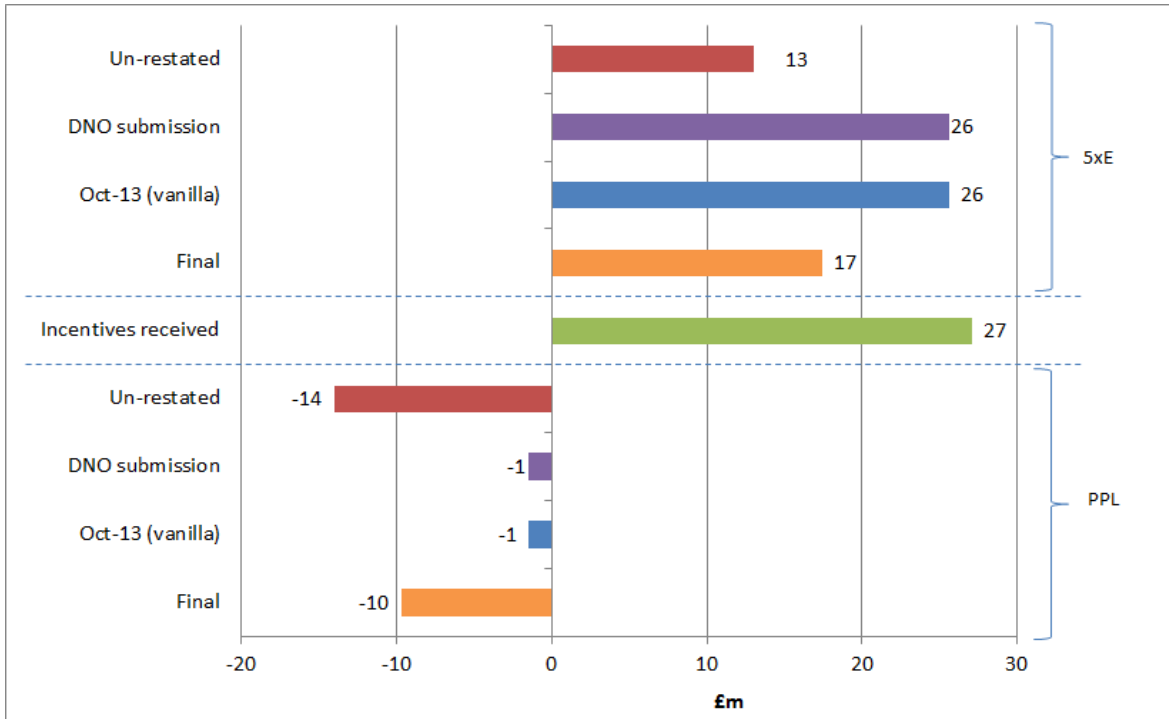


A1.14 SWALES did not apply for restatement.



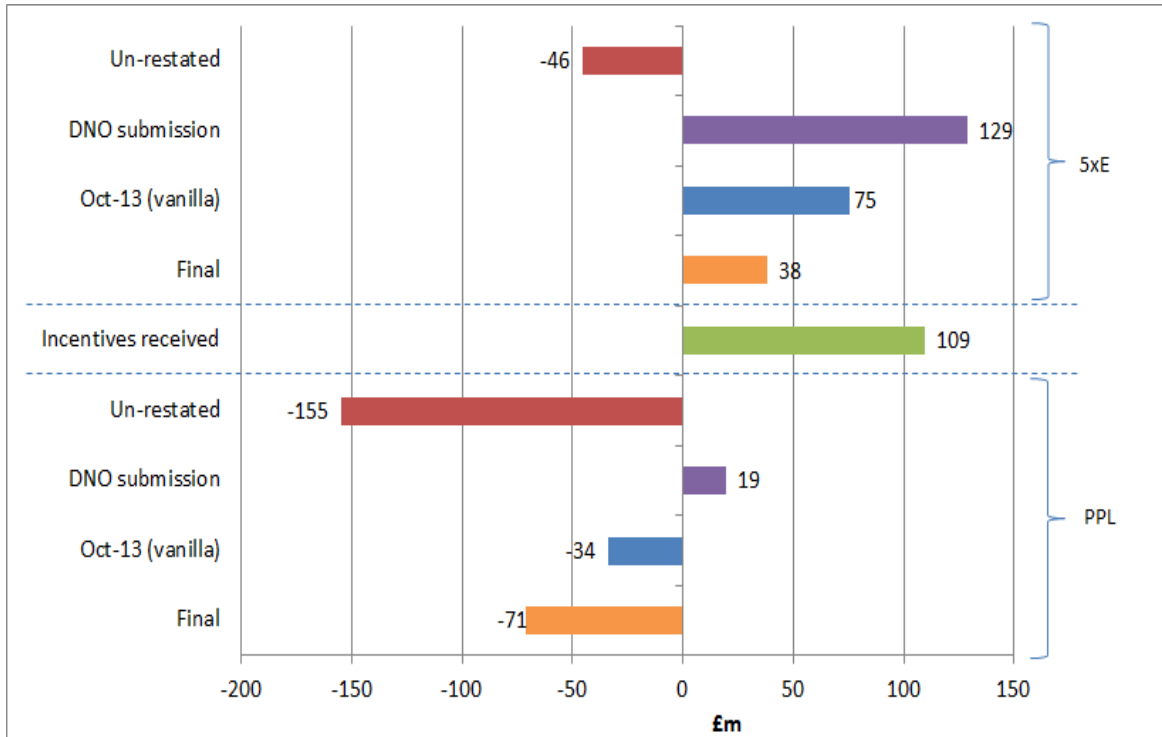
Decision on restatement of 2009-10 data and closing out the DPCR4 losses incentive mechanism

Figure 10 - DPCR4 losses final outcome for SWEST



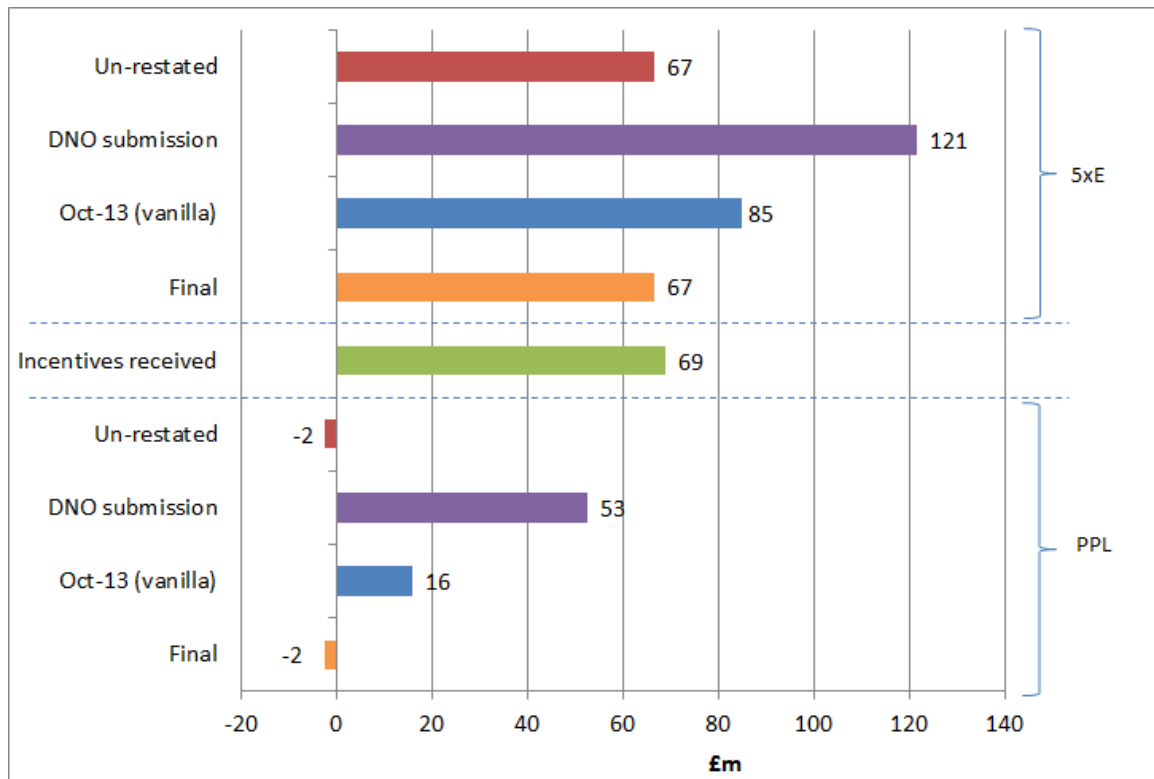
A1.15 Application of the strengthened credibility cap limits the overall rewards to SWEST by £9 million relative to its restatement submission.

Figure 11 - DPCR4 losses final outcome for EPN



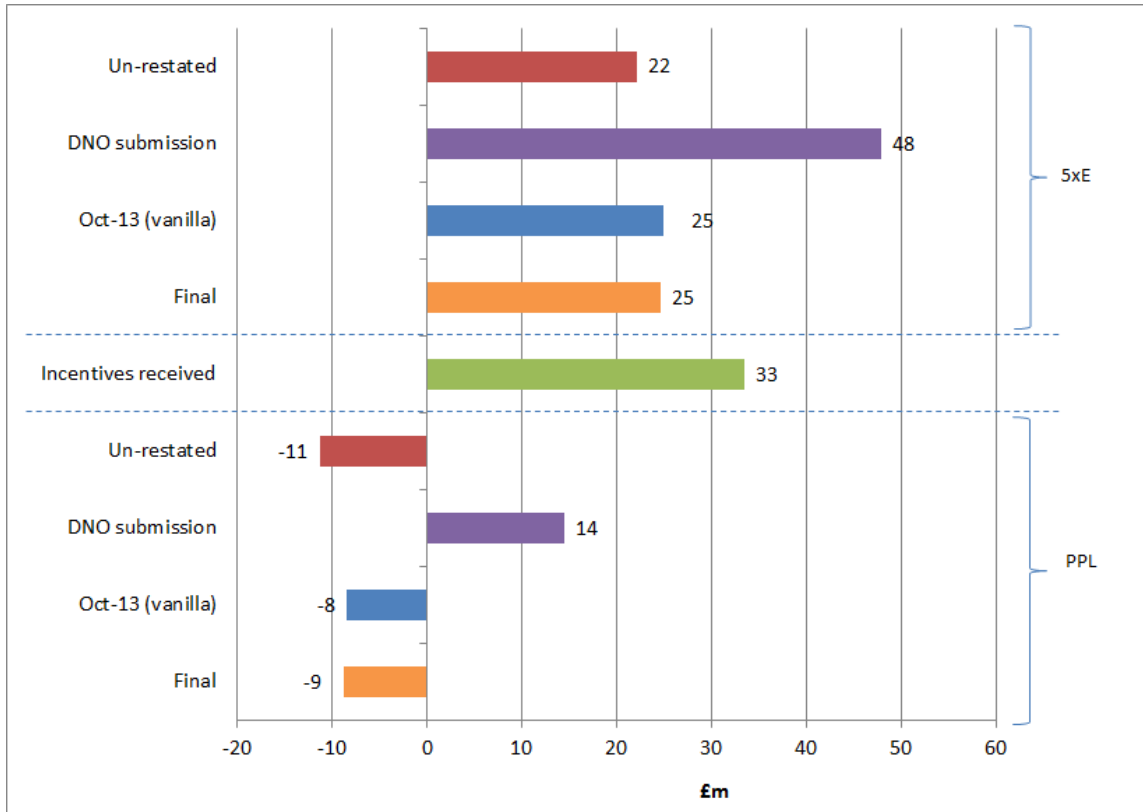
A1.16 Application of the strengthened credibility cap limits the overall rewards to EPN by £91 million relative to its restatement submission.

Figure 12 - DPCR4 losses final outcome for LPN



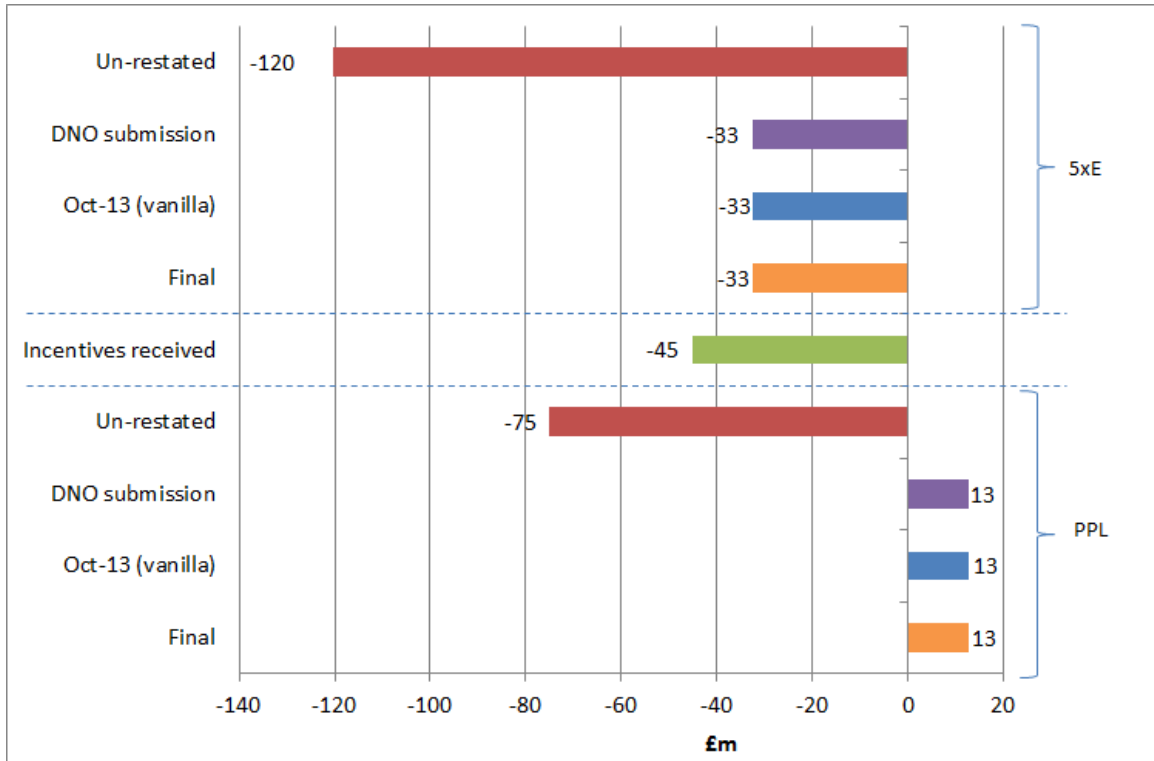
A1.17 Application of the strengthened credibility cap would result in higher losses for LPN than its un-restated position. To avoid this perverse outcome, LPN is closed out on the basis of its un-restated data. This limits the overall rewards to LPN by £54 million relative to its restatement submission.

Figure 13 - DPCR4 losses final outcome for SPN



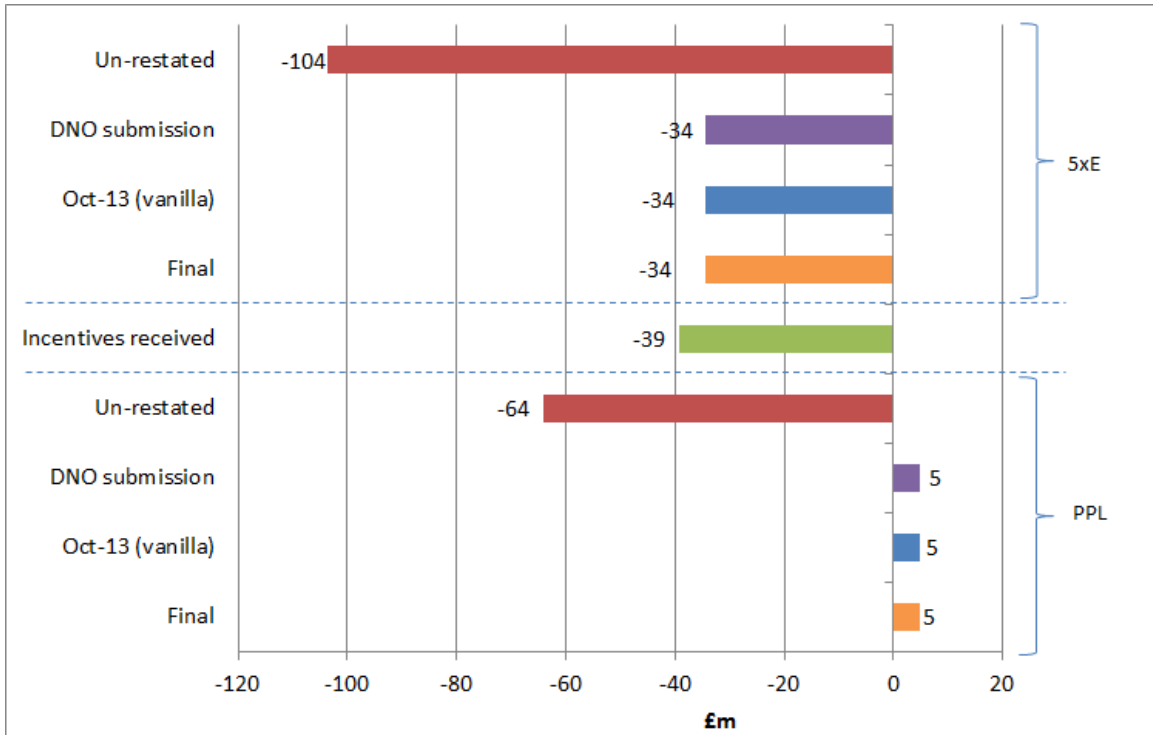
A1.18 Application of the strengthened credibility cap limits the overall rewards to SPN by £23 million relative to its restatement submission.

Figure 14 – DPCR4 losses final outcome for SPD



A1.19 Our decision to accept SPD’s restatement submission results in an overall £33 million penalty to the DNO over the DPCR4 period.

Figure 15 - DPCR4 losses final outcome for SPMW

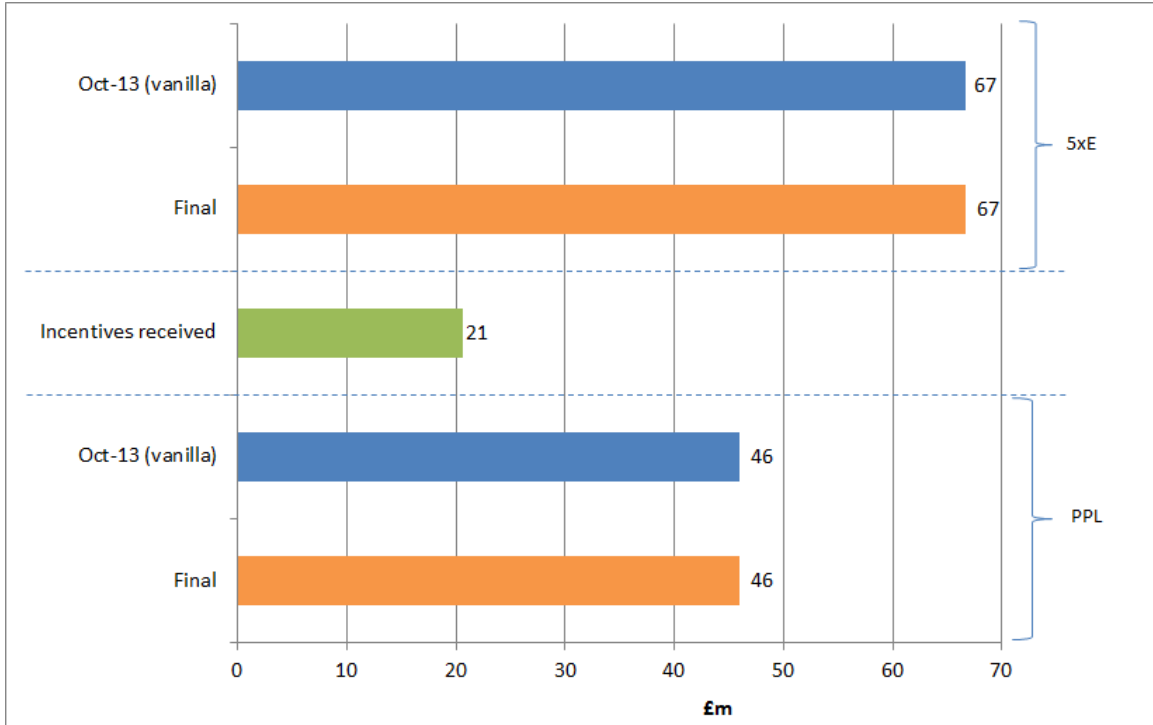


A1.20 Our decision to accept SPMW’s restatement submission results in an overall £34 million penalty to the DNO over the DPCR4 period.



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

Figure 16 - DPCR4 losses final outcome for SSES

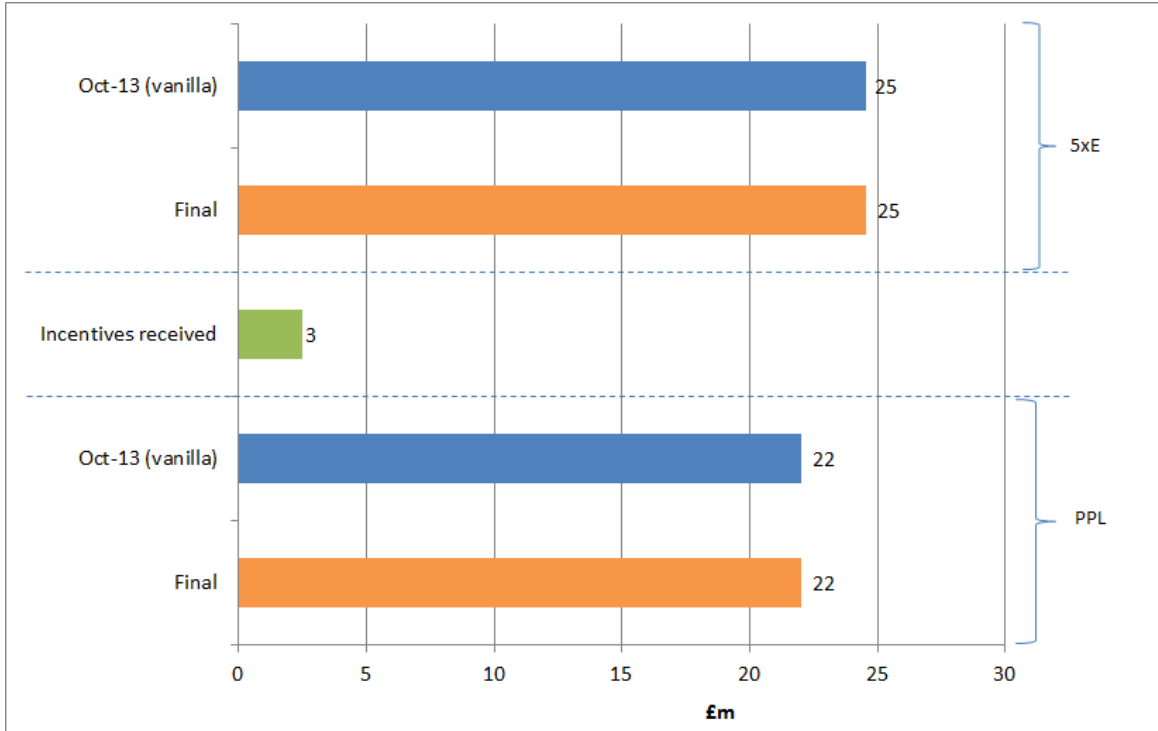


A1.21 SSES did not apply for restatement.



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

Figure 17 - DPCR4 losses final outcome for SSEH



A1.22 SSEH did not apply for restatement.

Appendix 2 – Components of PPL calculation

A2.1 Appendix 2 is available as an Excel ® spreadsheet published alongside this consultation. It contains the data and calculation steps necessary to reach the final PPL values for each DNO, consistent with the decisions in this document. The impact of different decisions on evidence for additional abnormality and alternative normal periods are also included for comparative purposes.

A2.2 It presents the final financial impact of the growth term for those DNOs that applied for restatement for the 2009-10 annual incentive.

A2.3 It also includes the data and calculations used to derive the figures in the PPL Direction that accompanies this decision.

Appendix 3 – Background

DPCR4 Distribution Losses Incentive Mechanism

A3.1 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.³⁴

A3.2 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

A3.3 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.

A3.4 During 2010 some DNOs noted high levels of data reconciliation corrections arising from abnormal levels of Gross Volume Corrections (GVCs)³⁵ 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.

A3.5 It is worth noting that our efforts have been focussed 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.³⁶ 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 DPCR4.³⁷

³⁴ In November 2012, we made a decision not to activate the DPCR5 losses incentive mechanism because of our concerns around the data used.

³⁵ 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.

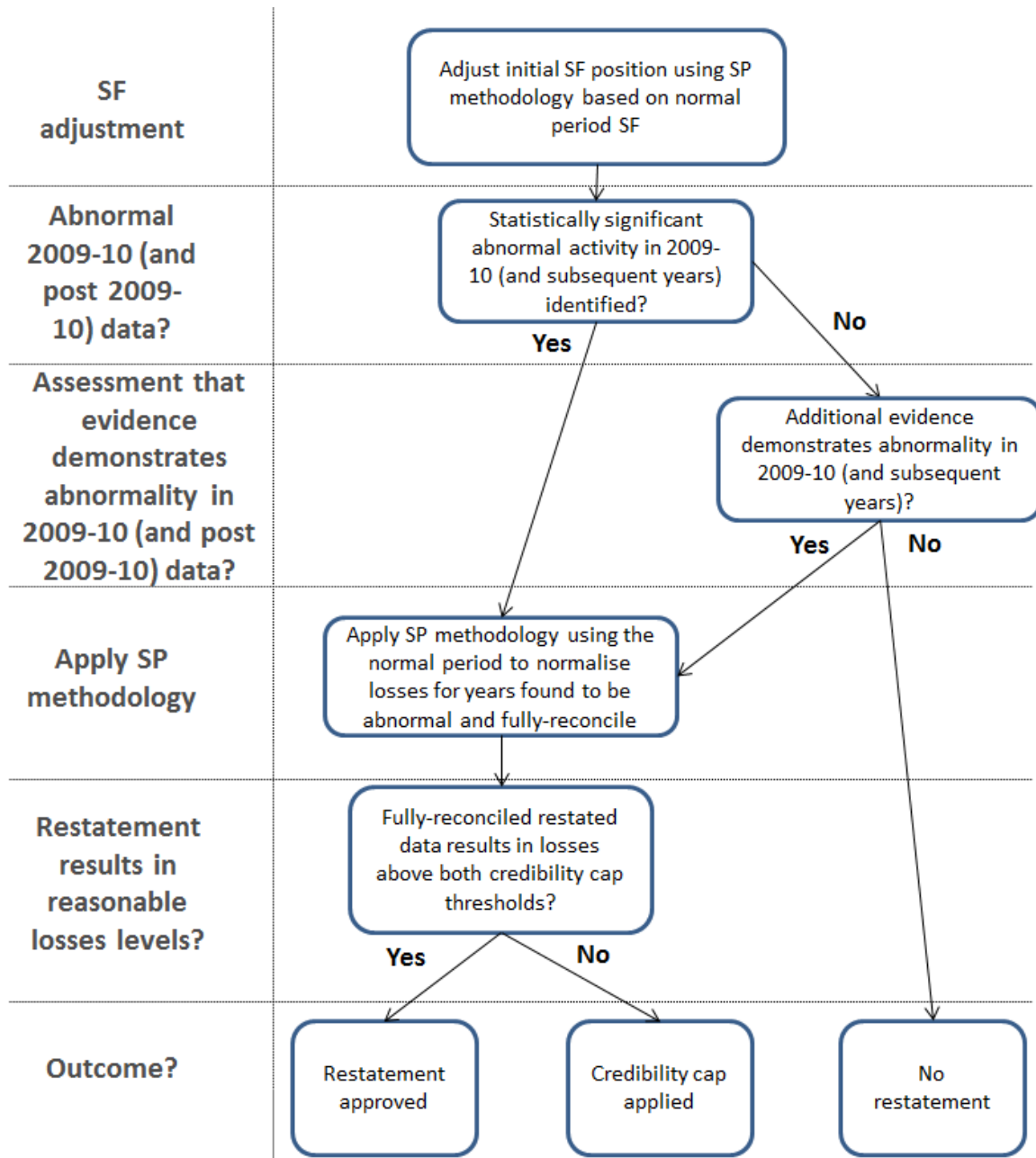
³⁶ Some GVC was part of the price control settlement

³⁷ This was established in the DPCR5 Final Proposals: <https://www.ofgem.gov.uk/ofgem-publications/45537/methodology-closing-out-dpcr4-losses.pdf>.

A3.6 Data cleansing tended to increase the recorded losses for affected DNOs for 2009-10, affecting the calculation of the close out position for DPCR4.

Restatement process

A3.7 A simplified representation of the restatement process for close out is shown in the diagram below. The key terms are described in the Glossary.



Normal period

A3.8 Identification of a 'normal period' is integral to the assessment of any abnormality and therefore the need to restate 2009-10 data.

A3.9 In our October 2011 consultation,³⁸ 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."

A3.10 Our 9 March 2012 decision letter³⁹ 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.

A3.11 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 own approaches where they could provide evidence that their own approach was statistically robust.

³⁸<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=607&refer=Networks/ElecDist/Policy/losses-incentive-mechanism>

³⁹<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=660&refer=Networks/ElecDist/Policy/losses-incentive-mechanism>

A3.12 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.

A3.13 In response to our July 2012 data request⁴⁰, 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.⁴¹ 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.

A3.14 Our 16 November 2012 consultation⁴² 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.⁴³ 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.

A3.15 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.

A3.16 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. Our October 2013 consultation sought 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.

⁴⁰ <https://www.ofgem.gov.uk/publications-and-updates/request-data-close-out-fourth-distribution-price-control-review-losses-incentive-mechanism>

⁴¹ SF is the Initial Settlement run in the electricity Balancing and Settlement Code settlements process.

⁴² <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=762&refer=Networks/ElecDist/Policy/losses-incentive-mechanism>

⁴³ Appendix 2 of the July 2013 document offers further detail on the statistical analysis.

Appendix 4 – Glossary

A

Abnormality test

A statistical test for comparing reconciliation levels in 2009-10 (and subsequent years) with the level over the first four years of DPCR4. More details are available in the July 2013 document.

Allowed Loss Percentage (ALP)

The target losses percentage determined for each DNO.

Allowed Revenue

The amount of money that a network company can earn on its regulated business

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 the July 2013 document presents more detail on Approach C.

B

Base Demand Revenue

The amount included in the licensee's Allowed Distribution Network Revenue for a particular Regulatory Year, that is derived in accordance with a formula set out in the distribution licence.

Bank of England Base Rate

The official bank interest rate that the Bank of England charges banks for secured overnight lending. It is the British Government's key interest rate for enacting monetary policy.

C

Combined Allowed Distribution Network Revenue

The revenue calculated in accordance with the formula set out in the distribution licence.

Correction factor

The value for an over or under recovery of revenue in one regulatory year which is brought forward into the following year.

Cumulative Sum (CUSUM)

CUSUM charts display the magnitude of settlement reconciliations (in terms of units of energy) over time, on a cumulative basis. Such charts can be used to show the overall trend in the underlying data and any spikes or abnormalities away from the trend.

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
SSEH	Scottish & Southern Energy: Hydro
SSSE	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 ran from 1 April 2005 to 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.

D

Distribution Use of System (DUoS) Charges

DNOs recover the costs of running their networks by charging suppliers DUoS charges.

E

5xE

E is used to refer to the incentive value for 2009-10 for close out. This figure multiplied by five (5xE) represents the total value of the incentive over the DPCR4 period for each DNO.

Estimated annual consumption (EAC)

EACs are used to estimate electricity consumption going into settlement for a given meter since the last time the meter was read.

F

Fully-reconciled

Reporting the data in relation to the period during which the energy flowed rather than the period that the data was received.

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.

L

Losses rolling retention mechanism (LRRM)

A mechanism designed to encourage loss reduction initiatives to be undertaken throughout the price control period.

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.

Net Present Value (NPV)

The discounted sum of future cash flows, whether positive or negative, minus any initial investment.

P

PPL

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

R

RIIO-ED1


The next electricity distribution price control which will cover the period from 1 April 2015 until 31 March 2023.

S

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 Reconciliation 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



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

SF adjustment

The SF adjustment is designed to estimate the size of post-SF reconciliations, taking into account any abnormality at SF. More details are available in our July 2013 document.

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.

T

Time value of money adjustment

A multiplier used when the award or application of a financial value, attributable to a particular year, is deferred until a later year, even where the deferral is routine and in accordance with a price control mechanism.

V

Vanilla assessment

Our assessment of DNOs' restatement submissions against the framework from our July 2013 document.

W

Weighted Average Cost of Capital (WACC)

The weighted average of the cost of equity and the cost of debt, where the weighting is provided by the gearing ratio. This represents the cost to a company of raising the funds for its activities.