



Consultation Response

SENT BY EMAIL TO: andy.cormie@ofgem.gov.uk

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Andy Cormie
Distribution Policy
Ofgem
9 Millbank
London
SW1P 3GE

Dear Andy,

ELEXON's response to Ofgem's consultation "Whether to activate the Distribution Losses Incentive Mechanism in the Fifth Distribution Price Control".

We welcome the opportunity to respond to the above consultation.

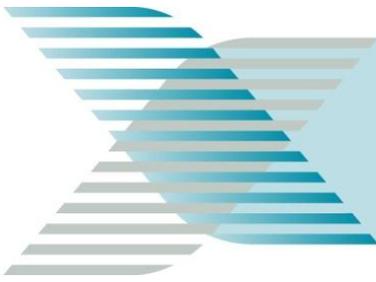
Please find attached our response to Chapter Two Question 1. We have confined our response to observations in relation to the use of Settlement data.

We confirm that this letter and its attachment may be published on Ofgem's website.

If you or your colleagues need anything further from ELEXON, please contact me on 020 7380 4313 or by email: jon.spence@elexon.co.uk.

Yours sincerely

Jon Spence
Market Advisor
ELEXON Limited



Consultation Response

Consultation on whether to activate the Distribution Losses Incentive Mechanism in the Fifth Distribution Price Control

Chapter Two

Question 1

Do you have views on whether the existing losses mechanism is effectively incentivising DNOs to reduce losses? Please explain your answer.

The consultation makes many references to the 'volatility' of Settlement data, as well as references to 'instability', 'unpredictability' and problems and issues with Settlement data. We appreciate that in many cases, Ofgem is reporting the views of the DNOs who have been adversely impacted in DPCR4 by changes to Settlement data. However, we believe this could easily create a misleading impression of Settlement data accuracy for anyone who is not familiar with the broader picture.

Gross Volume Correction (GVC) has the effect of compensating in current reconciliation timeframes for errors that occurred in previous (fully reconciled) timeframes and leads to a reduction in Non Half Hourly metered volumes across successive reconciliations. Over the last year at final reconciliation (June 2010 to June 2011) the percentage decrease in NHH volumes since the initial settlement run averaged 1.3%. A proportion of this reduction will be due to recessionary effects rather than GVC¹. So relative to the total volume of NHH metered energy settled, this represents a small volume of corrective activity. As is noted in paragraph 2.11 of the consultation, higher than normal volumes of corrective activity were carried out in 2009/2010 ahead of a change to the rules around the use of GVC. The reduction in NHH metered energy between the initial and final runs for April 2008 to March 2009 averaged a much higher 2.3%.

We would argue that Settlement data is not inherently unpredictable or volatile. Changes of between 1 and 2% across the reconciliation period are to be expected, as a result of recessionary effects and corrective activity. However, an unusually high volume of corrective activity occurred at an unfortunate time in terms of the Distribution Losses Incentive Mechanism, because regulatory year 2009/10 was critical both in closing off DPCR4 and setting targets for DPCR5. Whilst levels of correction are now much lower,

¹ In a period of recession, you would expect the volume of Non Half Hourly metered energy to fall over successive reconciliation runs, as Estimated Annual Consumption (EAC) values, which are based on historical consumption, are replaced by Annualised Advance (AA) values, which are based on recent consumption.



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Suppliers have indicated that gaining access to premises to install smart meters may result in the need for further corrections.

Modification Proposal P274 'Cessation of Compensatory Adjustments', which is currently in the Assessment Phase, is seeking to further limit the use of GVC. If the Proposed or Alternative Modification were to be implemented, this could reduce the extent to which adjustments are made prior to the Final Reconciliation run and increase the volume of Trading Disputes.

In summary, we would agree with the stakeholder views that are reported in paragraph 2.23, that the Settlement system was not designed for calculating distribution losses. As such, an incentive mechanism based solely on Settlement data is not effectively incentivising DNOs to reduce losses.

For more information, please contact

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