ScottishPower
gas and electricity

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Dear Mark

Regulation of Independent Electricity Distribution Network Operators – Initial Proposals Document.

Thank you for giving ScottishPower Energy Retail Ltd (SPERL) the opportunity to respond to the above initial proposals document. We have detailed our comments on the areas of the document relating to Charging Arrangements for the Independent Distribution Network Owners (IDNOs), nested networks and Boundary Metering.

We broadly agree with a number of Ofgem's initial views outlined within the document. We welcome the acceptance that the charging restrictions on IDNOs will also cover existing Distribution Network Owners (DNOs) operating out with their traditional area. This will make it easier for suppliers to use their existing pricing and billing systems.

We also agree that a tiered approach would be too difficult to implement. It would certainly cause problems for Suppliers as any suggestion of varying IDNO charges per IDNO would prove difficult to build into pricing and billing systems.

We broadly accept the proposal that the IDNO charges should follow the charges of the incumbent DNO (subject to a floor and ceiling). However, we still have some specific concerns on the detail of the Ofgem proposals. These concerns are outlined below:

Starting Point of Control:

Paragraph 5.4 of the document states that the starting point of the control should set the IDNO's initial charge at the **time of connection**. SPERL have a number of issues regarding this. From our understanding of the RPC model adopted by Independent Gas Transporters (IGTs), an estimated consumption will be calculated using a standard industry table based on property type and geographical location. Depending on the mix of customer types, the IDNO will set their charges equal to the incumbent DNO's charges at the point of connection i.e. date of contractual agreement with the developer or date of connection. The charges would then follow the DNO's charges within a +/- 5% ceiling. Our concerns relate to the following:

- Will an EAC (estimated annual consumption) be used at the starting point of the control?
- Will Suppliers have an opportunity to comment and influence this value?
- If standard industry EAC data is used, this may result in a cost exposure to Suppliers, as these values are normally higher than EAC/Annualised Advance (AA) values based on a full meter reading history.
- Will the IDNO continue to charge on estimated EAC at the point of connection for a set period i.e. 5 years or will actual settlement data be used?
- How often will these standard consumption data tables be revised?
- Vacant properties, de-energisations and re-energisations are a regular occurrence within the electricity market. How will IDNOs account for these instances within their charging?
- How will the charging arrangements operate on a development that includes domestic and non-domestic consumers?

Unless IDNO charges follow actual consumption patterns, Suppliers are exposed to costs that they may not be in a position to recover through their standard tariff arrangements.

Review period and starting date of RPC mechanism:

We do not agree with the principle of the rolling review i.e. that specific sites should be reviewed after a set period of operation. From a Supplier perspective, this would prove difficult to monitor and onerous to amend our pricing structures on an ongoing basis at individual site level. The period of review needs to be fixed for every site.

SPERL do not believe that the start of an RPC mechanism can be any earlier than 2006 because a lot of detailed work is still needed to determine the precise make up of any charging arrangements. A consultation/discussion period is needed to establish the detail of the price control.

Within the RPC mechanism in place for IGTs, charges are based on an estimated Annual Quantity (AQ) set for a period of up to 10 years with actual consumption recorded at the premise having no effect on the level of transportation charges applied by the IGT. In addition to this, no profiling of charges is applied in accordance with the consumption profile of the end user. This presents risks for Suppliers in that they may not recover their fixed costs if they acquire and thereafter lose a customer at specific periods of the year. We appreciate that this element of risk will not be as apparent within the electricity market as a more constant profile of energy consumption is present. It should be noted that there is a requirement for the AQ values to be reviewed on an annual basis. However, changes to the AQ value will only affect the element of Transco CSEP charge for forthcoming year and only where the IGT provides these new values to Transco. After the initial 10-year period, Ofgem intend undertaking an extensive review of the charging arrangements for IGTs.

If RPC was introduced for IDNOs based on equivalent guidelines as is present for IGTs, then Suppliers would face similar risks in that they may not be able to recover costs against revenue collected under current tariffs.

It is widely accepted by IDNOs that the longer the set period for RPC charging arrangements the greater certainty and stability that this provides for their long-term business security. However the arrangements adopted should not place undue risks to Suppliers and their customers. The exact components of any RPC model need to be considered in detail. Therefore at this time, we are unable to comment on the review period for IDNO charging. However, we would welcome the opportunity to participate in any discussion or consultation in this area.

Charging Arrangements:

Drawing on our experience in the IGT market and as outlined in our previous response, SPERL did not support the introduction of RPC for IDNOs as it is currently applied. This view was based primarily on concerns relating to the fixing of the AQ for a period of up to 10 years and the fact that actual consumption does not influence the application of charges.

Taking into account the nature of the new connections market and the increasing role of Independent Network Operators both in gas and electricity, the majority of domestic new housing projects are likely to sit on Independent Networks. Suppliers over IGT Networks already face financial risks associated with the previous Legacy Charging Arrangements and again, although to a lesser degree with the RPC arrangements, consumers over these Networks should not again be disadvantaged.

Ofgem require to take into account the greater complexity of the electricity settlement and Use of System (UOS) charging arrangements when developing the RPC arrangement to apply to IDNOs. Detailed discussions will be required if the interests of all Parties are to be protected.

Category of customers included under the charging arrangements:

We have concerns over the fact that the regulation of IDNOs charging arrangements will only cover Non-Half Hourly *domestic* customers and not *all* Non-Half Hourly customers.

As mentioned in our previous response we accept that UOS charges for Half Hourly customers are generally passed through to customers and as such Half Hourly billing systems have been built with the flexibility to pass on any increases or decreases in UOS charges. Therefore, it is acceptable for the UOS charges for Half Hourly customers to be out with the scope of any IDNO price control.

In addition, the introduction of a price cap for Non-Half Hourly domestic customers should mean that suppliers should be able to continue to offer to supply a P62 domestic customer based on the tariff offered to an equivalent non-P62 in the geographic area in which the IDNO is operating. We welcome this.

However, if the DUOS for Non-Half Hourly non-domestic customers (i.e. small business customers that don't have Half Hourly metering) is not covered by RPC then the DUOS an IDNO charges could be widely different from the incumbent's DUOS for the equivalent customers. This would mean that, where an IDNO is involved, the current tariff arrangements a supplier has on offer may no longer be suitable for this customer type. It would be impossible for suppliers to support these customers using their existing systems

and yet unrealistic to expect suppliers to change their systems for such a small subset of customers.

Extending any regulation to cover *ALL* Non-Half Hourly customers would alleviate this problem.

Current contractual arrangements:

SPERL acknowledge Ofgem's comments in paragraphs 7.3 – 7.13 regarding the current contractual arrangements in the electricity industry. We appreciate that Ofgem are attempting to quantify the costs and benefits of amending these so as to minimise IDNOs' liability for upstream DUOS charges.

However, as Ofgem state any changes to the contractual arrangements in electricity will require changes to industry systems that will impact on industry parties. SPERL would concur with this view and anticipate that any changes to the existing process would result in system changes at significant costs, and hence, such costs may impact customer tariffs. Further, SPERL see no justification for amending the current contractual arrangements in place for the recovery of DUOS. A robust settlement model is established in electricity and is supported by a framework of interdependent contracts and fully developed systems.

SPERL believe that there are a number of advantages with the existing arrangements. Firstly, the arrangements are transparent, simple, effective and low cost. Any major change(s) would not only be costly, but would take a considerable amount of time to be developed and implemented. Currently, the arrangements allow DNOs to operate with their license obligations effectively. Importantly, for Suppliers the current arrangements have minimal impact on Electricity Settlement systems and from a customer perspective they also have minimal impact.

Aligning gas and electricity structures:

SPERL recognise Ofgem's comments with regards to the alignment of gas and electricity structures, in paragraphs 7.6 – 7.8. As a supplier, in both markets, SPERL does see merit in attempting to align the structures of both fuels, when this is a viable option. However, with regards to contractual arrangements we believe that the current structure in the gas sector for IGT networks is fundamentally flawed. IGTs have contractual arrangements with NGT/Transco through the terms of the Network Exit Agreement (NExA). This agreement outlines the obligations of IGTs connecting to the NGT/Transco Network together with the requirement to provide key information in a timely manner. This data is required by NGT/Transco to ensure system balancing and security and to enable NGT/Transco to produce Transportation Invoices to their Shippers. However, IGTs and NGT have not managed information updates as prescribed within the NExA, which has resulted in the mis-allocation of energy values through the domestic Reconciliation by Difference settlements process. SPERL are of the view that any mis-allocation of costs is a serious matter and requires that the necessary steps be put in place to rectify the position.

At the most basic level, the proposal to align gas and electricity structures fails to take into consideration the fundamental differences between the gas and electricity settlements arrangements and the fact that there is far more complexity in the electricity market

arrangements.

Based on the issues and concerns stated above we believe that the failings of the current gas arrangements should not be replicated in electricity. We believe that the most efficient model for the regulation of IDNO networks is the one that is currently in place. This is one in which each IDNO is responsible for collecting all UOS revenue, both upstream and downstream, and each supplier receives one invoice for customers supplied via independent networks. If this were not to occur, SPERL would face costly system changes to accommodate alternative arrangements.

SPERL would therefore highlight the importance of Ofgem fully considering the limited benefits that changes to the existing arrangements would bring, especially the probable negative impact on end customers.

Nested Networks:

SPERL have been an active participant within the IGT market since inception and have taken part in discussions and workgroups previously held, regarding Relative Price Control (RPC). One of the issues discussed under RPC was the treatment of Nested CSEPs. As stated by Ofgem in the gas industry any intermediary embedded network does not receive use of system charges for use of its system to transport gas to end customers on a nested network. Hence, Shippers are only charged by the IGT to whose network the Supply Point is connected and by Transco for the CSEP element of the charge. Charges are not applied by any other IGT that make up the Nest.

For Shippers difficulties exist in the flow of information between IGTs and Transco to enable Transco to accurately calculate the CSEP charge. As previously highlighted, IGTs are obliged under the NExA Agreement to provide weekly updates. IGTs have admitted that they have problems receiving and subsequently submitting updates to NGT/Transco in a timely manner. The upstream IGTs have no knowledge of the timing of connections that are made by the IGT downstream. This also raises concerns in the event of a gas emergency occurring on an Nested CSEPs were key information relating to the end consumer may not be passed in a timely manner to the Network Emergency Coordinator.

If the regulation of nested networks in electricity is introduced as a replication of the current gas structure SPERL believes Suppliers and consumers would face similar issues.

Boundary Metering:

SPERL support Ofgem's view that there are numerous benefits associated with boundary metering. We would agree with Ofgem that the associated benefits would include more accurate information that will aid in the calculation of UOS charges and losses. Additionally we believe that the introduction of boundary metering would have further benefits including:

- The facilitation of a straightforward and minimal cost UOS recovery mechanism;
- Certainty to DNO UOS charges
- Will allow network losses to be identified

- Unlike problems experienced in the Gas Market, the introduction of boundary metering will protect DNOs from poor connection and settlement practices with regards to the IDNOs networks, over which they have no control.
- Boundary metering will also alleviate the current problems experienced in the gas industry with regards to the flow of information.

SPERL accept that there would be costs associated with the provision of metering. However, SPERL believe that these costs should be minimal and the benefits of boundary metering will definitely outweigh any costs incurred.

SUMMARY

ScottishPower broadly support Ofgem's proposal that IDNO charges should follow those of the incumbent DNO (subject to a floor and ceiling). However, detailed information is required on the proposal to introduce RPC Charging Arrangements for IDNOs especially in the setting of EAC values and whether actual consumption will be used by IDNOs to calculate charges. SPERL would be willing to participate in any meetings or discussion to take this initiative forward drawing on our experience within the IGT Market. We also believe that adequate time requires to be allowed to fully develop these arrangements prior to any implementation date being set. Within the IGT RPC arrangements a number of revisions have been made to the methodology for calculating charges for larger sites since implementation of the arrangements on 1/1/04. This has resulted in confusion and difficulty for Shippers/Suppliers in understanding and tracking change.

If you wish to discuss any of the comments made, please do not hesitate to contact me on the above telephone number.

Yours sincerely

Lorraine McGregor
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