



# SP Transmission & Distribution

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Your ref

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Date  
20 June 2005

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Dear Mark

## **Structure of Distribution Charges – Consultation on Longer Term Charging Framework**

I attach a response from SP Transmission & Distribution to the above consultation paper issued in May 2005. Please contact me if you would like to discuss.

Yours sincerely,

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## STRUCTURE OF ELECTRICITY DISTRIBUTION CHARGES

### CONSULTATION ON THE LONGER TERM CHARGING FRAMEWORK – MAY 2005

#### SP TRANSMISSION & DISTRIBUTION RESPONSE

Thank you for the opportunity to comment on this consultation on the Structure of Distribution Charges. This response is submitted by SP Transmission & Distribution, which owns and operates ScottishPower's three network businesses in GB – SP Transmission Ltd, SP Distribution Ltd and SP Manweb plc.

#### 1. USE OF SYSTEM CHARGING MODELS

##### Charge Setting Process

- 1.1 Our current methodology and charging models are based on forward-looking costs and satisfy the charging principles set out in 3.13 of the document. This methodology has been approved and any amendments to this will be developed in accordance with our licence requirements where we believe that the changes will better meet the relevant objectives. We would anticipate making minor changes in our methodologies to apply from April 2006 and possibly move to any agreed longer term arrangements from April 2007, providing we believe that the changes better meet our Licence objectives.
- 1.2 We support the basic principles that Ofgem is trying to achieve and, in fact, our charges currently meet most of these principles. We agree that the charging model going forward should reflect an estimate of forward looking costs. Our main concern, however, is the apparent belief that greater sophistication in the charging models will result in greater accuracy. Our fear is that Ofgem will support more complex charging models, which, in our opinion, are unlikely to be particularly cost-reflective. We believe that relatively simple charging models provide sufficient accuracy, particularly as the main inputs are forecast costs. This approach is consistent with the agreed charging principles.

##### Charging Principles

- 1.3 We support the high level charging principles that have been identified in 3.13 of the document as cost reflectivity, simplicity, transparency, predictability and facilitation of competition. We believe these principles will sit alongside the licence objectives.
- 1.4 We support the principle in 3.16 regarding economic efficiency and that suitable pricing signals indicate that this is the case. We also believe that peak demand/generation could be seen to be a key cost driver but it has to be recognised that different areas of the network can peak at different times e.g. areas where there is significant off peak load. Forecast investment costs should be based on the long-term development plan, or forward looking investment plans, which will have been submitted by all DNOs as part of their price review submission.

### **Current Charging Model**

- 1.5 Ofgem have described how the current DRM model may not be appropriate as the basis for the charging model going forward. We believe that this model should not be totally dismissed by Ofgem, as the use of customer yardsticks is a practical way of determining costs for most customer groups and should be retained. Therefore, it may be possible that the existing model could be amended to better meet the charging principles as set out in 3.13.
- 1.6 Paragraph 3.28 regarding assessing demand and generation is not too dissimilar to the DRM model and we would support the Ofgem view to use a similar framework.

### **Type of Model**

- 1.7 We agree in principle that tariff setting should be based on a long run forward looking cost model, which would also include a forward looking view of the development of the network. This would be based on the SLC25 long-term development statement, which has a five-year horizon. We also agree with the academics on principles, but we would strongly disagree with the NGC approach to setting charges, as we believe this does not meet the principles laid out in 3.13. As outlined below in point 1.11 we do not believe their approach is cost reflective, simple or transparent and the results obtained could not be described as predictable.
- 1.8 Paragraph 3.51 states that losses were highlighted as a cost driver in Strbac and Newbery's reports. In principle we would agree that the model should take account of losses but would disagree that they are a primary cost driver.
- 1.9 In determining the long term charging framework we would support progressing a model that could be adopted for both demand and generation. However, we also believe that different types of customers connected at low voltage through to extra high voltage should also be determined using the same model as this would allow us to avoid any mismatch when reconciling to the allowed revenue.
- 1.10 We continue to believe that the main locational signal for EHV customers should be determined by the connection charge and not through ongoing UoS, although our interim GDUoS charges currently include an element of locational pricing. We do not believe that locational signals are appropriate for non EHV customers as this would result in a large increase in industry information e.g. additional Line Loss Factor Classes would be required and the current industry processes can only handle a finite number (999).
- 1.11 We do not support building a charging model based on system load flows, as we believe that this type of model would not reflect future costs, would create unnecessary complexity and lack of accuracy. In summary, these models do not satisfy the charging principles.
- 1.12 Paragraph 3.97 welcomes views on whether an ICRP-type model could be adopted for DNO use. As explained above we would disagree that this type model should be adopted by DNOs. We feel that moving to such a model would add further complexity to what is already a complex area.

## **2. DETAILED CHARGING ISSUES**

### **Connection Charging Boundary**

- 2.1 For the interim arrangements a common charging boundary was agreed for both demand and generation. We believe that this 'shallowish' connection boundary is appropriate and should remain as part of the longer-term arrangements.
- 2.2 We would be opposed to shallow connection charges and locational DUoS charges being introduced and believe that they would not satisfy the licence conditions or the principles set out in 3.13. The majority of new Distribution connections are currently taken by developers who have no long-term interest in ongoing UoS as this will be paid for by the end user. Therefore, upfront connection charges should be used to provide locational signals to developers.
- 2.3 We disagree totally with paragraph 4.5, which states that the longer term regime may allow for a 'shallow' connection charging boundary, and believe that any major changes to the connections boundary would not be consistent with the current price control settlement, and so should wait until the next price review in 2010. In addition we believe that this would have a major impact on capital expenditure, which impacts on the sliding scale incentives in the current price control.

### **Charge Application Issues**

- 2.4 We agree that tariff structures should be transparent, and believe this is reflected within our charges. The fixed element of our tariff covers localised costs and the kWh charge covers the higher voltage costs. We will be undertaking a review of the number of tariffs within our area possibly to take account of rationalisation.
- 2.5 We agree to a common approach to line loss factor methodologies, and have recently submitted our methodology to Ofgem along with other DNOs in line with this approach, and believe that there is merit in a standard process. We also believe that this methodology should include total losses and not just the perceived technical losses.
- 2.6 Paragraph 4.19 describes how the model that will be used to produce a set of charges, is unlikely, without scaling, to derive the DNO's allowed revenue. We believe that charges should be scaled by a uniform percentage across all tariffs to arrive at the allowed revenue. We do not believe that the Ramsey pricing is the way forward as this method assumes accuracy in the model output and therefore places a greater burden on the DNO in its assumptions. Scaling factors are likely to be greater in Scotland due to the differences between Scotland and the rest of the country given uplift in the Scottish companies' privatisation price.

### **Generator Charging Issues**

- 2.7 Paragraph 4.27 states that generators connected prior to April 2005 will have paid deep connection charges. We would disagree with this statement and believe that while this is theoretically correct, prior to April 2005 very few generators would have paid deep connection charges due to these types of schemes not going ahead.

Therefore, our view is that from April 2010 all generators should pay the same GDUoS charges. However, we believe a review should be carried out for all generation that was connected prior to April 2005 to assess their connection charge under the new rules.

- 2.8 We agree with Ofgem's view that the area of distributed generation and deferred expenditure requires further investigation. As there is no mechanism in the current price control and the benefits are minimal, this area should be regarded as a long term issue for discussion within the next price control in 2010.
- 2.9 We cannot see any issues from a charging point of view in relation to ancillary services in the short term. We would view this as an added complication to the current process which can be dealt with as a long-term issue to be resolved at a later date.
- 2.10 We support DNOs accurately reflecting additional costs associated with poor power factors associated with demand and generation connections, and believe that our current reactive charges reflect these costs. We currently charge both demand and generation customers in the same way levying charges on any customer who has a power factor of less than 0.95.
- 2.11 We note the supplier concerns in relation to paragraph 4.45, but it is our view that it should be a supplier's responsibility to obtain data from their customers.

#### **Development Process Issues**

- 2.12 We believe that there would be a benefit in DNOs working together and producing a high level common model, this would provide each DNO their own flexibility and allow innovation and development. However, each DNO should produce its own methodology statement and we believe that Ofgem should not seek to insist on one methodology.
- 2.13 We agree in theory with some interaction between transmission and distribution charging as described in paragraph 4.49. However, we would object to the transmission methodology being enforced as the distribution methodology. As stated in 1.7 we do not think that NGC's current charging methodology meets the charging principles and also that the number of circuits, nodes and customers on the distribution system is significantly different to that of the transmission system, which merits a different approach.
- 2.14 We agree in principle to publishing the indicative model to enable suppliers to understand our charges. However, we would not wish to include the full set of data and assumptions, as some information could be classed as confidential, impose additional costs and allow for further questions from users.
- 2.15 IDNOs should be treated as a normal demand customer and should produce their own methodology statement. In the Structure of Charges Workshop there was a discussion about potential double counting for connections to IDNOs systems. All customers connecting to the system face the possibility of double counting or to not being charged for some costs. This is because the DUoS charging model will make some assumptions on what costs will have been recovered through connection charges and which will be recovered through DUoS. This is unlikely to be significant and does not justify IDNOs being treated differently from any other type of customer.

### **3. IMPACT ASSESSMENT**

- 3.1 We note Ofgem's view that there is no requirement for an impact assessment, as any changes would be DNO commercial initiatives rather than regulatory policy. We support this view and we believe that it is for DNOs to bring forward changes, as they feel appropriate. However, any attempt by Ofgem to force changes on DNOs is a regulatory policy issue and we believe that Ofgem should carry out a formal impact assessment if it decides to go down this route.
- 3.2 We believe that costs will be minimal if a simple model is adopted. However, if a sophisticated model is insisted upon this will lead to significant costs with little or no benefit.

### **4. IMPLEMENTATION**

- 4.1 We do not believe that this is a single project as each DNO is required to produce its own methodology, however, we see merit in everyone working together to achieve the required result, but we reserve the right to produce our own methodology, which will have to be approved by Ofgem.
- 4.2 The future role of the ISG we believe should be a consultation group who would meet at key points in time. DNOs should have prior input into this group before meetings take place.