

## **Introduction**

I refer to the consultation on Regulation of Independent Electricity Distribution Network Operators, July 2005.

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.

## **Price Control Mechanism**

As stated in our previous consultation responses we broadly support the implementation of a relative price control model based on the incumbent Distribution Network Operator's (DNO's) charges for Independent Distribution Network Operators (IDNOs) and DNOs operating out of areas effective from 1 April 2006. We continue however to have concerns that the proposed mechanism fails to recognise the difference between DNO and IDNO cost and revenue drivers. As outlined in our previous response the model relates IDNO charges, and hence revenues, directly to the incumbent DNO's charges. DNO charges, however, are driven by approved UoS methodologies to recover allowed revenue which, in turn, are affected by a number of incentives including those for IIP and losses, the growth term, and year-on-year adjustments for over and under recovery. Therefore there is scope for an IDNO's charges to be driven inappropriately by the DNOs performance in these areas rather than its own. We accept, however, that the proposed 5% floor and ceiling relative to the DNO's April 2006 prices in real terms will limit the scope for such movements. Accordingly, subject to the points below we broadly support Option 1 for the charge restriction on the grounds of simplicity and consistency in levels of charges between IDNOs and DNOs.

The DTI's current consultation 'A cost recovery mechanism for protected energy companies in energy administration' (August 2005), acknowledges in paragraph 5.26, that under the current regulatory arrangements, increases to the DNOs charges as a result of, in this case the implementation of a mechanism to recover the cost of the energy administration of a protected energy company, would enable the IDNO to increase its charges. Accordingly the paper proposes that the licence modification contains a paragraph to ensure that the increase to DNO charges is disregarded by the IDNO. We believe that a similarly worded paragraph should be included within the draft revised standard condition BA1 contained in Annex 1, to ensure that any increase in DNO charges attributable to this cost recovery mechanism are disregarded for the purpose of the cap on the IDNO's domestic UoS charges.

Also, there appears to be an inconsistency between paragraph 2.20, which implies that each component of the IDNO's charges should be capped, and the draft licence condition BA1, which refers to overall DUoS charges to typical domestic customers. We don't see a need for a cap on each component of the IDNO's tariff.

As the paper recognises, special condition G in DNO licences (covering DNO out of area charge restrictions) will need to be modified to be consistent with condition BA1.

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We believe that it would be appropriate to review IDNO charge restrictions after a 5-year period to examine whether a link to DNO charges should be retained.

### **Commercial Arrangements**

We strongly support Ofgem's decision not to change the structure of the contractual relationship between the upstream DNO, IDNO and suppliers in electricity distribution. As detailed in our March 2005 response the electricity industry has developed a robust settlement model supported by a framework of interdependent contracts and participant systems which are acknowledged by an Ofgem sponsored industry forum, facilitated by MRASCo, as the most efficient and low cost solution for the industry as a whole.

### **Boundary Metering**

We note Ofgem's statement in paragraph 4.19 recognising 'that boundary metering is an important issue and that 'it is necessary to identify a suitable mechanism that ensures that electrical flows on the boundary can be measured or estimated accurately'. We are pleased Ofgem have confirmed that 'the cost of any such mechanism should be borne by the connecting party (the IDNO).' As outlined in our March 2005 consultation response we believe that IDNOs should be able to install low cost boundary metering with minimal impact on the equipment at a new development. In that response we detailed the major benefits that we believed resulted from the provision of DNO/IDNO boundary metering and stated our contention that these far outweighed the low cost of implementation. It is therefore our continued view that boundary metering provides the least cost solution in the majority of cases.

Two alternative mechanism briefly outlined in paragraph 4.20, the utilisation of real settlement data aggregated up accurately to the boundary, or the installation of metering remote from the boundary, are both unsatisfactory mechanisms for the following reasons. The utilisation of settlement data would require significant investment in system development that the connecting IDNO(s) would be liable for. The cost of this could be several millions of pounds thereby making such an option uneconomical.

Substation metering increases the complexity of the connection solution, as a greater degree of technical input would be required on a case-by-case basis. This would substantially increase the costs and timescales to the IDNO of the connection.

We acknowledge that there may be specific jobs where metering at the IDNO/DNO boundary is not possible, in which case the least cost option will be adopted.

### **Boundary Equipment**

We are concerned by Ofgem's statement in paragraph 4.10 that 'There is a requirement on licensees to identify minimum cost connection arrangements.' This fails to acknowledge the statutory and licence obligations DNOs are required to satisfy in providing connections to other parties, such as IDNOs. Whilst we are committed to identifying minimum cost connection arrangements, our obligation to meet the legal, commercial and safety requirements of the Electricity Act and our distribution licences can, depending on the

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nature of the connection, mean that additional costs may be incurred and this should be acknowledged.

We welcome Ofgem's statement in paragraph 4.8 that 'in order to satisfy regulation 6 of the Electricity Safety, Quality and Continuity Regulations (ESQCRs) distributors have to fit protective devices to their networks. Consequently fuses or circuit breakers will have to be fitted at each point of connection.' While we recognise that the interface between each IDNO and DNO will have its own unique characteristics we believe that, in general, a standardised approach is preferable to avoid unnecessary uncertainty and costs resulting from assessing each case on an individual basis.

We are concerned that whilst paragraph 4.8 and 4.9 provides comfort that a single protection solution at the connection boundary will, for the majority of connections, be sufficient to satisfy the ESQCRs' requirements, there is insufficient clarity as to when a more complicated technical solution would be viewed as appropriate. We are currently in discussion with the DTI seeking additional clarity.

We are pleased Ofgem have confirmed that 'the IDNO requiring the connection should pay for the protection/ isolation equipment at the interface'.

### **Credit Cover Requirements for Upstream DuoS.**

We welcome Ofgem's consultation on the appropriate arrangements for credit cover at the distribution interface having raised it as an area of concern within our March 2005 response. Under the current arrangements the IDNO, similarly to a supply company, is required to enter into a Distribution Use of System (DUoS) Agreement with the incumbent DNO prior to their network connection being energised. The UoS agreements contain credit cover requirements and bad debt provisions. While these provisions were developed specifically to address the commercial relationships between the DNO and supply companies we would expect them to apply equally to existing and new IDNOs. Accordingly we support the application of the revised credit cover management and bad debt provisions, as outlined in Ofgem's 'Recommendations for best practice guidelines for gas and electricity network operator credit cover' (February 2005) to apply to new and existing IDNOs in the same manner as to supply companies. We believe that within the electricity distribution market, the consistent application of these guidelines across all DUoS agreement counterparties is the most appropriate and effective option.

We are unclear, however, as to how the guidelines' bad debt recovery mechanism would be applied in the case of an IDNO insolvency and seek an opportunity to discuss this with Ofgem at the earliest opportunity.

We would however also support, in principle, the utilisation of a trust arrangement as an alternative mechanism to the provision of credit cover for securing upstream DUoS charges. Such structures are regularly used in a commercial environment, providing a simple and transparent approach. For such an arrangement to work the mechanism should be constructed so as to be robust to the challenge of other IDNOs creditors. The implementation of a trust mechanism would need to be accompanied by appropriate

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amendments to the DUoS agreement between the IDNO and DNO. We would expect the costs of implementing such an arrangement to be borne by the connecting IDNO

### **Other Licence Conditions**

We broadly support the proposal to move SLC 34, 35 and an amended 48 into all distribution licences so as to provide consistent arrangements for all distributors. In relation to SLC 35, we note Ofgem's acknowledgement, in paragraph 5.13, that 'distributors will have to apply safe practices to deal with potentially multiple circuits of different ownership in pavements and highways to ensure that they satisfy the existing street works legislation.'

As detailed in our April 2005 consultation response we have significant safety and plant protection concerns regarding the potential proliferation of parallel networks that may result from the extension of SLC 35 to IDNOs and DNOs operating out of area. As detailed in our response we believe that there are a number of possible means of resolving these issues ranging from simple solutions such as the inclusion of the asset owner's name on the marker tape that is laid above all cables to more comprehensive arrangements such as the placing of an obligation on all distribution licence holders to supply network drawings to a centrally administered registry, similar to that which is operated on a voluntary basis in Scotland.

As regards the financial ring-fencing licence conditions, we recognise that many of the amendments broadly reflect those applied to DNOs as part of the recent Distribution Price Reviews. There remain some editorial/drafting issues (e.g., reference to "permitted" rather than "agreed" in BA6 paras 3 and 4). We would expect that over a period of years an IDNO should be expected to obtain an investment grade credit rating, to avoid the need for continued reliance on individual arrangements with the Authority.