ScottishPower

energy management

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Dear Samanta,

STRUCTURE OF GAS DISTRIBUTION CHARGES – INITIAL PROPOSALS

Thank you for giving us the opportunity to respond to this document. I am writing on behalf of ScottishPower's Energy Wholesale and Retail businesses.

In our view, initial thoughts seem to advance a series of proposals which serve to further the interests of the Distribution Network operators at the expense of shippers, suppliers and most customers.

Cost-Reflectivity of Use of System Charges

We support the principle of cost-reflective charging. We agree that we should move towards making distribution UoS charges more cost-reflective. With gas transportation, however, it is difficult to move towards cost-reflective charges without adopting a piecemeal approach which disadvantages certain customer groups and cross-subsidises others.

However, one of our principal concerns is for our customers and we are reluctant to support any changes to the charging methodology which could lead to considerable changes in tariff structures or significant increases in customer tariffs. We feel that gas prices, recent tariff increases and current market dynamics as we increase our import dependency mean that this is not an appropriate time to be considering wholesale changes to tariff structures.

We do not agree that tinkering with selected elements of charging to make them more cost-reflective will encourage a more efficient use of the system, although it should lead to lower transportation costs and charges for some system users, and increased costs and charges for others.

Capacity and Commodity Split

We have reservations about the way changing the capacity and commodity split would influence behaviour in the market.

First, it could have a detrimental impact on suppliers' charging structures. It may be difficult for suppliers to absorb a significant change of balance between capacity and commodity charges. As the upward pressure on wholesale gas prices feeds into retail gas prices, customers are getting a stronger signal to reduce consumption. Suppliers would be paying a higher capacity cost at a time when volumes are reducing. Retail tariffs would have to change to reflect this with a move towards higher standing charge tariffs.

Higher fixed charges in customer tariffs may be undesirable for a number of reasons:

- It would be against the wishes of customers. Suppliers have tariffs in place that emphasise low or no standing charges in response to demand from customers in the marketplace. Customers could see the end of no standing charge tariffs.
- There are social implications. Tariffs that tend towards a higher fixed element relative to the variable element have distributional effects that penalise low-income households. There would be inevitable knock-on effects such as increasing debt levels.
- There will also be environmental considerations. Tariffs that emphasise the fixed element over the variable element give poor economic signals to customers to be more efficient in their consumption. It may be that a move to a greater proportion of capacity charges might be contrary to Article 10 of the proposed EC energy end-use efficiency and energy services directive. Article 10 requires the removal of incentives in transmission and distribution tariffs that unnecessarily increase the volume of distributed or transmitted energy.

It may also introduce periodic volatility in customer charges as suppliers incorporate tighter forecasts of capacity followed by backward-looking reconciliations.

Secondly, there could be an impact on network efficiency. We recognise what the proposal is trying to do but we believe an approach that includes all customers is too broad. It is hard to reconcile an attempt to control peak demand with a drive to a capacity charge that covers domestic customers. Giving the correct economic signals to domestic customers can dampen peaks in demand that they drive, but moving towards higher fixed charges and lower volume charges does not do this. In the longer term, investment decisions could be made that lead to an inefficient network configuration.

The revenues to be realised from all distribution network customers could be split between domestic and industrial and commercial customers. A commodity-based charge could be applied to domestic loads and a largely capacity-based charge applied to business customers.

Customer Charges

Ofgem believes this will be made more cost-reflective by levying it only on a capacity basis.

This change could be potentially more significant than the proposal to increase the capacity-commodity split. We do not feel the impact of this change on various loads has been adequately assessed in the initial Impact Asessment, and that this would need to be done before any change in the charging methodology – as well as taking into account the information from Distribution Networks on their underlying costs.

We doubt whether this would allow time for adequate consideration and consultation to allow an implementation date of April 2006.

The Economic Test on contribution towards Connection

We agree with Ofgem's second option regarding the Economic Test – it should be changed to become more transparent and include the latest/most relevant information. We regard the benefits of this approach to outweigh the costs associated with the potential for disputes and gaming – as long as these activities are closely monitored going forward.

CSEP Administration Charges

We agree that this process should be kept under review by Ofgem.
IGTs are required under the terms of the NExA Agreement to submit timely updates to Xoserve to allow them to manage and thereafter calculate the proportion of Transportation Costs relating to DN Owners and to facilitate the reconciliation of Larger Supply Points as obliged under the terms of the UNC.

ScottishPower have argued for sometime that the contract arrangements and processes in place to support the accurate charging of Shippers are inadequate. From statistical information provided to Shippers by Xoserve it is clearly evident that serious issues exist over the frequency and quality of updates made, with no verification possible that IGTs are submitting all Supply Point activity over their Networks. The problem is compounded where Nested CSEPS exist with the lead IGT regularly reporting that they receive no AQ Updates from IGTs downstream of their Networks.

It is clear that the current processes for provision of AQ values by IGTs to support the allocation of CSEP transportation charges to Shippers is inadequate. Ofgem have reported that they consider that the CSEP Administration Charge reflects the costs incurred by the DNs in managing CSEP information under the existing processes. ScottishPower would argue that while this may be the case, a full review of the processes are required to determine whether the revenue collected under CSEP Admin Charge is being utilised in the most efficient and economical way to manage CSEP information. It has been suggested that the implementation of an automated solution may introduce additional costs, however at this time these costs have yet to be substantiated. Automation would provide a number of benefits including increased confidence in the timing and accuracy of cost allocations.

In addition to the automated management of CSEP information, we would request an immediate review of the NExA Agreement to ensure adequate incentives are placed on all both IGTs and DN Owners to prevent continued Breach.

Surveys and Auditing

We are fully supportive of Ofgem's proposals for reviewing key data. We agree that the kind of information shown in Appendix 2 would add to the transparency regarding the Economic test.

As noted above, we would be keen to look at the impact on various groups of customers of changing the customer charge from being commodity to capacity based, since we feel the impact of this could be as significant as the change in the capacity-commodity split.

The IA on the split makes it look as though there would be significant benefits to all in the event of Interruptible reform. We would like to see what the benefits would be of maintaining the 50:50 split along with interruptible regime reform. We would also be keen to understand how interruption will be paid for under the new regime.

Should you wish to discuss these comments further, do not hesitate to call me on the above number.

Yours Sincerely,

Steve Gordon

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ScottishPower Energy Management Limited