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Colette Schrier
Distribution Policy
The Office of Gas and Electricity Markets
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28 July 2008

Dear Colette

Re: Consultation and impact assessment on Scottish Power's (SP's) proposed modifications to their use of system charging methodology; long term methodology for EHV and revised approach to HV/LV demand and generation charging

I am writing on behalf of CE Electric UK Funding Company (CE) and its wholly owned electricity distribution licensees Northern Electric Distribution Limited (NEDL) and Yorkshire Electricity Distribution plc (YEDL). This letter provides our response to your recent consultation on Scottish Power's (SP's) proposal for longer-term charging arrangements.

I should point out that, in view of Ofgem's recent decision to put in place a licence obligation on all distribution network operators (DNOs) to deliver a common charging methodology, and the ongoing work to develop our own long-term charging proposals, our response in this instance is more in the nature of a summary of our views than a detailed response to the specific questions posed.

The Ofgem consultation on SP's proposals has identified the following areas as being pivotal in the debate over the practical application of the charging principles:

- Cost reflectivity, including averaging;
- Different approaches to setting demand and generation charges;
- The extent to which the use of a ten-year recovery period impacts upon the forward-looking aspect of the model; and
- Other issues including IDNO charging, the use of P2/6 in recognising the benefit of intermittent generation at LV and reactive power charges.

As Ofgem itself notes in the consultation, any methodology is required to achieve the relevant charging principles - this requires the industry to find an appropriate balance of objectives, which may pull in different directions. It is not clear to us how much weight Ofgem will put on each of the principles so we are therefore unable to assess with confidence how Ofgem might balance these competing objectives in making its own assessment of the methodologies under consideration.

We also note the comment that Ofgem believes that this modification is a significant step forward in SP's charging arrangements. However, in our view, there is currently no perfect solution available and the methodologies that have been developed so far need to be measured as to which best meets the majority of the defined principles and any model will need to be further developed in the longer term.

The forward-cost pricing (FCP) approach used by SP at extra high voltage (EHV) appears to fail to meet a number of the key principles. For example:

- the approaches for demand and generation charges are inconsistent, thereby distorting the cost signals between demand and generation;
- it does not appear to reflect all cost drivers as future reinforcement is not considered unless the utilisation of a circuit exceeds 87% of its rated capacity - such an approach is likely to add instability to the charges and reduce predictability;
- throughout the structure of charges (SoC) process it has been recognised that averaging charges at high voltage (HV) and low voltage (LV) is appropriate due to the complexity of the networks at this level. However, at the EHV level customers, both current and future, are more able to respond to the impact they have on the network and therefore more site-specific charges are appropriate. The FCP approach appears to average EHV charges within network groups, thereby diluting the locational signals that may well have materialised at individual nodes on the network within each group; and
- the approach to generation charging is based on the addition of blocks of generation (which are based on historical trends and uptake instead of future expectations) rather than incremental cost that should be used to derive the marginal cost or benefit on the network.

At lower voltages the use of capital costs from historic data in the regulatory reporting pack (RRP) appears to fail based on its use of retrospective data rather than being forward looking, which we believe to be a key principle of any methodology. Whilst this data may be appropriate for operating costs that vary little year-on-year, it does not seem suitable for the more volatile capital cost.

We recognise the amount of work that has been put in by all DNOs in this area and are committed to working with Ofgem and with other DNOs to progress the SoC project to develop a common approach to charging which can be utilised by all DNOs. I trust the above sets out our concerns sufficiently, and would like to assure Ofgem of our willingness to participate in any groups that are established to take forward developments in this area.

Yours sincerely

A Jenkins

Andy Jenkins