Your ref: 86/08

Our ref: MC/01/07/08

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29th July 2008

Dear Rachel,

ScottishPower's Proposed Modifications to their Use of System Charging Methodology

Thank you for your correspondence of 17th June 2008 inviting comments on the proposal from ScottishPower to modify their UoS Charging Methodology.

Clearly the document covers a wide range of topics and, in expressing the views of Energetics Electricity, I've considered the proposal in the context of SP better achieving the relevant objectives wherever possible.
Turning to the specific questions raised in the consultation document:

The use of Network group aggregation and different increments.

In general terms the approach taken by SP to use Network Groups, as opposed to Nodes, does appear to offer a suitable balance in terms of cost reflectivity and stability on the understanding that these groups are readily identifiable down to the 33KV level. However, the view taken by G3 in discounting the use of individual nodes (Frontier Report 3.1.1) raises some doubt on the comment about the subjective nature of network open points. Regardless of whether SP use network groups of individual nodes, the choice of network open points, once made, are thereafter relatively stable down to the 33KV level.

The use of network group aggregation along with separate increments would appear to be a sensible balance in terms of using publicly available data to satisfy the requirements of cost reflectivity in the context of identifying when and where reinforcement would be required. The issue that requires some further explanation is the use of 'standard costs' in determining the overall costs to be recovered. I fully support the view taken by Frontier Economics that reinforcement schemes at the EHV level should be estimated on a project-by-project basis thereby giving the transparency that allows these estimates to be challenged, if required.

Turning to the charge pricing function, without being drawn into a mathematical discussion, the overall concept of ensuring that the charges are such that the total revenue recovered is equal to the forecast reinforcement costs is clearly desirable

and the 'pure model' would appear to achieve this aim. This of course is predicated on the understanding that the forecast reinforcement costs are accurate (and not determined using standard costs) and also that the reinforcement is actually carried out in the forecasted period and not subjectively pulled forward thereby changing the NPV, and hence increasing the charges. Once again referring to the Frontier Economics report, SP's attempt to create a unique mathematical formula to effectively ensure that they would not be in a position of under recovery of revenue is extremely cumbersome. On the basis that the main variable here is the time to reinforcement, particularly should this reinforcement be required earlier than forecast, then arguably SP would be able to identify these schemes and agree any tariff changes with Ofgem.

The use of a test size generator and standard probability in EHV/HV generation charges.

The use of a test size generator, aligned to the probability of connection over a 10 year period, would appear to be a sensible approach in terms of smoothing the profile and also giving some degree of transparency and stability of costs. The down side with this method is the lack of cost reflectivity but it's difficult to see how this could be improved other than charging the generators for the net impact on the network at point of connection, which brings us back to the current status.
Although the increase of small scale generation could potentially flatten any 'lumpy' connections at the EHV level, the reality is such that the majority of generation, in terms of capacity, is connected at EHV and therefore the potential smoothing effect of small scale generation would be relatively minor.

Varying the size of the test size generator.

The observation that as the TSG increases then charges fall, and vice versa, does appear counter intuitive and does raise questions on the suitability of applying a TSG. However, simplistic as it may seem, this could be a function of the forward looking benefits whereby larger generation contributes a net benefit to that particular network group resulting in lower charges. In any event, the analysis conducted by Ofgem would indicate that further work is required by SP to explain these test results.

Revenue Reconciliation.

While recognising that some form of scaling will be required, the main concern from Energetics Electricity is the lack of clarity on the yardstick customer groups. Ofgem has already identified the lack of specific IDNO yardsticks in this proposal and the fact that IDNO's are not yet in a position to assess the impact of these far reaching changes on their business is frankly unacceptable. The main concern from Energetics Electricity is that these proposals are ultimately accepted with the final yardstick customer groups being tagged on at the end. As part of Ofgem's response to SP there must be a clear instruction for them to finalise their proposals for IDNO's in the context of these major changes to their charging methodologies in order that the full extent of their adherence to the relevant objectives can be assessed prior to any decision being taken on their proposal.
As far as the methodology to calculate the allocation costs between yardstick groups is concerned, the only comment worth highlighting is the fact that in many instances the establishment of an IDNO network will invariably lead to avoided costs for the DNO and again this has to be considered in the context of a specific yardstick for IDNO networks.

It was interesting to note that despite the extensive work conducted by Reckon and Frontier Economics, neither of them identified the role of IDNO's in the context of promoting competition.

Use of historic RRP data in HV/LV charging.

It would be fair to say that the use of rolling average RRP data does in fact give an element of predictability and, to a lesser extent transparency, in relation to the charges set. However, the fundamental issue is that they are not cost reflective considering they are set using historical data. The obvious concerns with this approach is that historical costs can be significantly different from one year to the next and the actual data supplied via the RRP is not broken down to a level where 'reasonable' forward projections can be calculated. Furthermore, the data provided through the RRP is not audited and is merely taken as reported.

Time banding

The rational for using four time periods for HV/LV customers and only one time period for EHV customers has not been made clear in the consultation document. The principle of encouraging customers to recognise system peaks and thereby improving utilisation of the network is certainly a worthwhile goal. The question that comes to mind is how the four time periods will be evaluated and recognising that factors such as life style changes, impact of generation, climate change and energy prices in general will all have the effect of moving these peaks over the course of any period. More information is required on the proposed time periods and the impact on charges before an accurate view can be taken on this particular proposal.

With regards to the 10 year period to recover the cost of reinforcements, this arguably improves the cost reflectivity element of the resultant charges on the basis that data is taken from the Long Term Development Statement. The comments from Frontier Economics regarding a more cost reflective 20 year period would certainly be more desirable. However, the comments on current issues such as climate change and oil prices added to the uncertainty around network growth beyond 10 years do indeed make it difficult to take a longer term view.
One possible suggestion would be to take a reduced element of reinforcement cost for projects beyond 10 years rather than assume a zero cost and avoid the possible scenario where charges could be artificially deflated.

Finally, may I take this opportunity to thank you for the opportunity to comment on this proposal and we look forward to receiving your views on the best way forward.

Yours sincerely

Mark Cummings
Director
Energetics Electricity