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Dear Colette

Re: Consultation and impact assessment on Scottish Power's proposed modifications to use of system charging methodology: longer-term methodology for EHV etc

Thank you for the opportunity to provide views on this important consultation about the future structure of distribution use of system charges levied by Scottish Power.

In May 2008 ESP Gas Group Ltd acquired the electricity network assets of Laing O'Rourke Energy and became a licensed Independent Distribution Network Operator (IDNO). While we do not presently own assets in either of the two licence areas where Scottish Power is the host DNO, we are responding because this initiative forms part of a wider structure of charges development process.

This response addresses three areas:

- our objectives from DNO use of system charging;
- overall direction of the structure of charges project; and
- three specific comments on the Scottish Power proposals as consulted on by Ofgem.

Objectives from DNO use of system charging

As the operator of a small number of IDNO systems and having the aspiration to increase our presence in the electricity sector, we think it fundamental that DNO use of system charges—which provide the baseline for our own charges—are subject neither to unexpected shocks nor to margin squeeze, as both these factors can impinge on the viability of our own investments. Our starting position for the longer-term charging development work currently being undertaken by the DNOs is one of seeking to minimise charge disturbance for our existing customers, subject to the maintenance of commercial and operational viability of our investments.

In this context we would note that once set our own charges to customers can be difficult to change. Major shifts in method by any of the DNOs is likely to give rise to charge instability but also result in asymmetrical charging with our own customers increasing risks of margin squeeze.

Direction of the structure of charges project

We believe much of the G3 work being consulted on under this initiative has been superseded by Ofgem's recent proposal to mandate a common long-term use of system charging methodology for the DNOs. We support Ofgem's proposal for standardisation as we believe it will make the market for distribution services much less complex, and we will respond formally to the most recent consultation in due course.



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We also believe the opportunity should be taken to work IDNO issues in at the baseline of any new structure of charges development process rather than to address it—as occurs at present—as an afterthought. This would eliminate the perception that DNOs may be setting their IDNO charges tactically to achieve desired outcomes rather than fundamentally reflecting the different costs that IDNOs have on their systems compared to other classes of end users.

Therefore for present purposes we believe that development work on the G3 charging methodology should be halted. This is because this work is quite different to the work being taken forward by other DNOs, notably the methodology that has been used by Western Power Distribution since April 2007 and the transmission charging methodology used by National Grid since the mid-1990s.

As a guiding rule, whatever charging methodology may be adopted, it should (as we mentioned above) minimise the scope for pricing shocks. It should also place emphasis on simplicity, transparency and predictability. Only if there are clear and well substantiated benefits from a more complex approach should other options be contemplated. Ultimately the DNO is aiming to recover its full allowed regulated costs and the overall pattern of charges to customers and their movement year-on-year is subject to a range of other factors other than cost-reflectivity in the underlying methodology.

Specific comments on the Scottish Power proposals

We are concerned the SP consultation proposals ignore IDNO charges, and welcome Ofgem's intent to consult separately on this development once proposals emerge, should this work-stream continue in its present form.

We have two further specific concerns about the Scottish Power proposals, that

- the effect of the charge changes appears to be to narrow the range between charges for users connected to the HV and LV networks. It could be that this approach is a tactical consequence of the proposed new methodology that will act to limit the potential for IDNO competition; and
- likewise we fear the shift from volumetric to fixed/capacity elements could have a similar effect.

We have not provided a detailed commentary on the proposals themselves but would note generally that any such changes in charging methodology could appropriately be vetoed at this point in time. It would seem counter-productive to allow further divergence when Ofgem and industry are to embark on a move toward commonality in methodology. A further strand of work is underway between IDNOs and DNOs on a collaborative basis and against tight timescales to understand the potential for an interim cost-reflective IDNO charging structure. It would be preferable that any changes beyond this are fed into the broader considerations of the structure of charges project.

I hope these views are helpful and would be pleased to provide more detail as required.

Yours sincerely



David Speake

ESP Electricity Limited