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29th July 2008

Dear Rachel,

Consultation and impact assessment on Scottish Power's proposed modification to their use of system charging methodology.

SSE welcome the opportunity to comment on Ofgem's consultation paper dated 17th June 2008, inviting views on Scottish Power's (SP) charging methodology modification proposals. In providing our views we are conscious of the Authority's recent decision and further consultation regarding a common charging methodology.

As highlighted in your consultation document, we have been working closely with SP and Central Networks (CN), known as the G3 group, in developing a forward cost pricing (FCP) methodology. The development work on this common FCP methodology is substantially complete with SSE, and we believe CN, now in a position to follow SP by submitting proposals to the Authority to modify our UoS charging methodologies. We are currently giving consideration to the recent decision letter and its implications for our own modification submission.

At the outset of the G3 project to develop the FCP methodology it was identified that it would be essential for the final solution to be sufficiently flexible to accommodate a wide variety of DNO networks types, for example, the very low density rural network in the north of Scotland as well as the high density urban systems found in the midlands and the south of England. Another important consideration was to ensure that the methodology and any future developments of it could be incorporated into the diverse range of business IT systems owned and operated by the G3 companies. Our experience of working with SP and CN on these very important aspects of the design and development of FCP has highlighted the scale of the many challenges associated with finding common workable solutions to some very complex situations. The G3's success in this area has a great deal to do with the willingness of all parties to work together to find the best outcome that satisfies not only individual party requirements but also the group requirement as a whole. When considering these issues in relation to the Authority's decision for a common methodology, we believe that the FCP methodology is a very strong contender for adoption by the other DNOs.

We are pleased that Ofgem has recognised many of the benefits of the FCP methodology and has acknowledged that SP's proposal represents a significant step forward. We also recognise Ofgem has initial concerns with some of the effects of SP's proposals and we are aware of the ongoing process by which Ofgem is seeking to gain a better understanding of these effects. For example, the recent meeting between our Pricing and Tariffs team and senior representatives from Ofgem's Distribution Pricing Policy team provided us with a valuable opportunity to clarify many of Ofgem's outstanding issues associated with G3's FCP methodology. We also took the opportunity to explain how we are currently developing the FCP methodology to include, for example, a range of IDNO tariffs.

We strongly believe that SP's proposal better achieves the Relevant Objectives set out in SLC 13.3 of their Electricity Distribution Licence. In particular, the FCP methodology mitigates the worst excesses of marginal cost pricing and strikes an appropriate balance between the high level principles of cost reflectivity, transparency, predictability, simplicity and facilitating competition. Whilst the FCP methodology does provide a view of future costs, it dampens the volatility of the pure incremental cost models and, we believe, provides a more stable and predictable charging regime which is particularly appreciated by suppliers and generators.

Other benefits from SP's proposal include providing locational price signals to EHV demand and generation customers in 128 network locational groups. These locational groups consist of a number of interconnected nodes representing the actual electricity network. The methodology also recognises both the costs and benefits of demand and generation customers in the different locational groups. The methodology goes on to make use of a common tariff model to bring together demand and generation charges at all voltage levels. Allowed revenue is recovered by, as far as possible, using allocation based on appropriate cost drivers rather than simple scaling and minimises distortion of price signals by scaling tariffs using a fixed adder for each voltage level to reflect each voltage level's share of costs not allocated within the tariff model.

During our recent meeting with Ofgem's Distribution Pricing Policy team we explained in detail how our planning engineers carry out the process of identifying the requirement for network reinforcement. In summary, this involved using AC load flow analysis of the actual network during normal and abnormal conditions and including both thermal capacity and fault level considerations. The output of these studies was then used to identify differential price signals for the recovery of anticipated network reinforcement costs within an appropriate time horizon. It also allowed for the assessment of generator prompted reinforcement using test size generators allowing consideration of national targets for the connection of distributed generation. SP follow a very similar process which ensures the outcomes accurately reflect the actual situation on their network.

The experience gained from working with SP and CN to create the FCP methodology included taking account of the other methodologies, either currently in use or under development by the other DNOs. This provided the G3 with a valuable insight to some of the options available to us. Where appropriate, the G3 introduced some of the better aspects from these methodologies into FCP. We therefore strongly believe that FCP will provide the firm foundation on which to build a common methodology that not only meets all the licence requirements but also satisfies the requirements of all

the relevant stakeholders. This methodology is also relatively easy to understand and, in our experience, has low implementation costs.

In summary, we fully support SP's proposal to introduce the G3 FCP charging methodology. We therefore strongly urge the Authority to approve the SP proposal in order to realise the substantial benefits offered from this much improved methodology.

Please call me if you need clarification on any of the above matters.

Yours sincerely,

Malcolm J Burns
Regulation Manager