

Colette Schrier Distribution Policy The Office of Gas and Electricity Markets 9 Millbank LONDON SW1P 3GE

Dear Colette,

Consultation and impact assessment on EDF's proposal (UoS Mod 21) to introduce a LRIC-based UoS charging methodology, ref: 95/08.

SP Energy Networks ('SPEN'), on behalf of SP Distribution and SP Manweb, welcomes the opportunity to comment on the issues raised in this consultation.

EDF's approach to implementing an LRIC-based method highlights the very problematic shortcomings of the "uncorrected" LRIC method – the production of very high, or even excessive, incremental pricing signals in particular for highly utilised networks with low growth rates. These issues have been highlighted on numerous occasions by SPEN and other industry participants, as well as consultants¹.

In terms of generation charging, we believe the approach adopted by EDF does not accurately model generation reinforcement costs, as it does not take into account all relevant cost drivers, and therefore is not cost reflective.

We would like to focus on a few key points raised in the consultation document, as well as other points as detailed below.

Application of a power flow scaling factor

As mentioned in the consultation, EDF has decided to use this "scaling factor" solution in order to avoid the high charges arising from the application of the LRIC approach to networks with high level of utilisation and low growth rates.

We cannot see any economic justification for the application of an arbitrary power flow scaling factor, and we agree with Ofgem's assessment that it introduces distortion of the pricing signals (Table 7 of the consultation document). However, we do not believe that the solution would be to avoid scaling and use the "raw" results on an LRIC model. This would give rise to a much worse problem: the production of unacceptably high charges to some customers and possibly even negative charges to others (due to scaling). This latter effect is clearly unacceptable, as it would cause cross-subsidy between demand customers which would be due to an erroneous methodology and not to real cost reflectivity.

Figure 6 of the consultation document shows the utilisation in EDF's SPN network. It illustrates that for the majority of the cases the power flow inputs would have to be scaled in order to produce acceptable charges under an LRIC methodology. In other words, the LRIC methodology only produces "sensible" results under a restrictive set of assumptions or conditions. This surely cannot be desirable in a methodology which should work for every reasonable pricing scenario and across a variety of networks.

Use of the LRIC method and annuity factor

We believe there is no economic justification for using the nominal asset life (40 years) as a fixed annuity period to recover the incremental costs (i.e., convert the \pounds/kVA costs into

¹ See Reckon report at <u>http://www.scottishpower.com/StructureOfChargesProjectG3.htm</u>



 $\pounds/kVA/year$). Any annuity factor for cost recovery should be made under the payment period (or cost recovery period). Otherwise, the price signals that customers face, in present value terms, do not reflect the cost of reinforcement incurred, as they often will be paying these annual charges for less than the assumed life of 40 years. Another problem with the LRIC methodology is that it produces counter-intuitive results: charges are lower when growth rates are higher and vice versa. This invalidates any economic argument supporting the application of the LRIC, and clearly points at the need to find an appropriate substitute for this approach. SPEN believes that the FCP, "G3", method² addresses these problems and should therefore be preferable as a long term solution as the "uncorrected" LRIC.

Generation charges

We believe that the proposal does not adequately model generation reinforcement costs, as it takes no account of fault level and reverse power flow, which are the main cost drivers for generation connections. In order to accurately reflect the generation cost drivers the charging methodology needs to recognise and properly model that generation and demand growth are not symmetrical.

Nodal analysis and the use nodal maximum and minimum demand

For the flow analysis to be truly cost reflective the reinforcement needs to be determined under each contingency case (N-1 and N-2), as prescribed by P2/6 rules, as this is what will drive reinforcement costs in the network. It is our understanding that EDF's "sensitivity coefficients" are derived only under normal operating conditions. This means that cost reflectivity is compromised under this approach. However, to do a full contingency analysis at the nodal level would significantly increase the computations needed as well as increase volatility. Frontier Economics conclude that the G3's approach of using Network Groups to perform the contingency analysis is an appropriate balance between cost reflectivity and complexity³.

Transparency and predictability

We believe there are aspects of the EDF report where transparency, in terms of sources for the data being used, could be improved. For instance, LTDS levels of demand are used, however it is not clear where the "expected demand in five years' time" is taken from or how it is derived. This has an important impact on the final tariffs as the growth rate is derived from these two numbers.

In summary, we believe that the EDF proposal should be vetoed. We cannot see how the Authority can approve a method which only works under certain conditions in terms of utilisation and growth rate, especially when the conditions observed in all of the networks in GB point to a trend going in the opposite direction. This clearly cannot be considered the charging solution "for years to come".

Yours sincerely

Jim McOmish

Distribution Policy Manager

² Long term Structure of Charges methodology developed by SSE, CN and SPEN and recently submitted by SPEN to consideration by the authority, see

http://www.scottishpower.com/uploads/v4100608SPENG3Modificationreport.pdf

³ Frontier report available at <u>http://www.scottishpower.com/StructureOfChargesProjectG3.htm</u>