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Your ref

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Dear Rachel

September Update to Initial Proposals

SP Distribution and SP Manweb (SP Energy Networks) welcome the opportunity to respond to Ofgem's September Update to Initial Proposals.

Distribution Network Operators (DNOs) have a central role to play in the delivery of energy policy objectives and in facilitating economic recovery.

In this context we are enthusiastic about a number of the policy decisions proposed, however we have reservations about the effective translation of these into practical application. The proposals outlined in the September Update fail to do this in a number of cases and will result in clearly unintended consequences.

This letter highlights some of the higher level concerns whilst the attached appendix answers in greater detail some of the specific questions posed.

Load Related Reopeners & Drivers

Given the current uncertainty regarding the timing, nature and effect of environmental policies (e.g. electric cars), we welcome the introduction of reopeners and drivers. *Ofgem is aware that we have adopted the lowest load growth projection in the Industry to forecast our most likely reinforcement needs. We believe that customers are best served in this instance by adopting relatively conservative projections upfront, coupled with the proposed re-openers and drivers.*

However, as proposed the current drivers do not recognise the market penetration and consequential effect of Independent Distribution Network Operators (IDNOs). These connections result in DNO to IDNO connections that are not in settlements, have no MPAN, and in c.50% of cases are at a higher voltage than the end customers.

If the proposed reinforcement drivers and reopeners are not refined to take cognizance of IDNO connections then the mechanisms will inadvertently penalise those companies that facilitate the greatest degree of competition in connections/network ownership.

We comment on the timing of proposed re-openers later.

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Rising and Lateral Mains (RLMs)

Of all DNOs, SPEN made the highest submission in relation to this asset category, based on our industry leading asset management approach to these assets, and also as a consequence of there being a greater proportion of flatted properties in the SPEN areas than industry average. Given the safety-critical nature of this investment we welcome Ofgem's decision to provide us with an ex-ante allowance for the first two years of DPCR5, but have concerns regarding the timing of the re-opener to deal with the spend required over the remainder of the period.

Timing of Re-Openers

In respect of RLMs the proposed application window commencing 31 March 2012, with a decision deadline within 4 months (e.g. 31 July), set alongside the normal price-setting timetable will not enable revenue adjustments to be made until late 2012. The gap in revenues during the early part of 2012/13 could lead to unnecessary volatility in prices and to a possible delay in work programmes in the affected areas.

To minimise these problems Ofgem could simply extend the ex ante allowance to cover a further 12 months of the DPCR5 period. If price volatility is considered of secondary importance then Ofgem could agree a clear timetable and deadlines to ensure that price adjustments, if required, are co-ordinated with the end of the period covered by the initial ex ante allowance .

In respect of Load-related expenditure, we believe the application date of March 2010 is too restrictive and potentially too early in the DPCR5 period to establish sufficient certainty to make an application. We believe that either this date should be set to March 2013 earliest, or there should be at least two opportunities for load reopeners during the DPCR5 period.

Logged up costs

We are somewhat surprised at the proposed 95% 'incentive rate' to be applied to any logged up costs. We presume that this is a mistranslation of policy in the drafting as this is not an incentive mechanism but a penalty that will apply regardless of scale of spend or degree of efficiency.

The majority of costs in this category relate to projects of national importance driven by central government. When there is a clearly communicated need for these projects to progress then the regulatory framework should support this.

Companies already have to bear the burden of logged up costs during the price control period, and the risk that a proportion of these costs could be deemed inefficient at the following price control. The nature of a logging up mechanism with efficiency test at the next price control provides an adequate incentive to DNOs to minimise costs.

HILP

As part of our DPCR5 stakeholder engagement we *have already* completed a detailed customer survey of major customers in the business districts affected by our HILP proposals and there was no support by these customers to be charged directly for these.

Given these improvements are intended to minimise the effects of major system events that have an impact on the wider economy and have consequences for all customers, there is a clear case for these costs to be socialized across all customer groups.

These are investments of strategic importance and should not be constrained by the willingness to pay of a specific customer group during a recessionary period. We believe that these should be funded via an ex ante allowance subject to truing up through the reopener process.

Transmission exit charge incentive

These proposals are flawed in principle and in proposed application.

Setting aside our opinion, shared by all DNOs, that it is inappropriate and double-dipping to incentivise Transmission exit charge, the proposals reflected in the September update and the published financial models do not appear to be consistent with Ofgem's policy decision.

The September proposals, by including all forecast exit charges into an ex ante allowance, have the effect of introducing an incentive on 100% of the exit charges. This runs counter to Ofgem's "minded-to" position that increased charges, related to asset replacement and Distributed Generator driven new GSPs, or extensions, should continue to be subject to straight pass through.

For the regulatory mechanisms to reflect Ofgem's policy decision any incentive should apply only to new load growth related costs.

Low loss investments

We have communicated our reservations regarding Ofgem's assessment of low loss investments on a number of occasions.

We agree however with the funding proposals so long as they do not constrain the low loss investments specifically to the ones identified by Ofgem in the September Update, and so long as the target adjustment is as specified in this document.

BT 21

It is disappointing that Ofgem have not fully scaled back other DNOs forecasts in line with the latest updated programmes from British Telecom. DNOs that did not reprofile their submissions have only been scaled back by 1 year, whilst the implementation programme has been extended by 3 years. As one of the companies most affected by BT21C, and therefore most sensitive to any decisions taken by BT in this area, it is unhelpful if this relative acceleration of other DNOs' programmes compared to ours, reduces the Industry-wide demand on BT to prolong its existing service for as long as possible. We suggest that Ofgem's revise this treatment to deal with Companies on a more equitable basis.

I hope that these points are clear and that Ofgem can make the necessary changes to correct these for the Final Proposals. Should you have any queries please do not hesitate to contact us.

Yours sincerely



Scott Mathieson
Regulation & Commercial Director

Appendix 1 : Network Cost Assessment

Question 1: Do you consider the volume drivers proposed for customer demand connections to be appropriate?

To manage uncertainty in the demand connections arena, in a time of economic downturn and a drive to open the market to competition, we consider that the ability to flex shared use investment driven by volume is a positive step forward in this area, However there are a number of issues that lead us to think that an alternative mechanism is more suitable

1. The complexities of the currently proposed mechanisms, which requires identification of shared use costs in multiple LV categories is practically very difficult and administratively complex to implement. It will require the creation of additional administration overheads to manage the separation & reporting of costs
2. We believe that there are still significant scope differences between the defined volumes and costs supplied by different DNOs in Table 3
3. The mechanism also does not balance movements from DNO or ICP to IDNO, as it does not reflect the (credible) scenario of significant movement of market share to IDNOs which in many cases, (e.g. for developments >40 houses) will involve HV connections. This represents c.50% of the 350 IDNO connections in the SPEN area. There is no volume flex in the HV allowance, and the loss of LV LV volumes would penalize the DNOs.
4. The materiality of the money involved vs the complexity is disproportionate.

It may be possible to utilise IDNO boundary maximum demands and ADMD to establish a pseudo customer number for this driver.

However, we feel it would be simpler, and far more transparent, and with less risk for customers to true up the shared use connection costs (and associated customer contributions) at the end of DPCR5, for all LV and HV (with HV) connections rather than get involved in a complex volume driver process that may well be superseded by IDNO penetration.

The re-opener mechanism for connections involving EHV is appropriate, however further flexibility to make this mechanism effective is required, by allowing a DNO to trigger the re-opener any time during DPCR5, rather than just during one small window in 2013

Question 2: Do you consider the proposed reopener for low volume, high cost connections and general reinforcement appropriate? Is it set at the right level?

We consider that the re-opener for low volume, high cost connections and general reinforcement is appropriate to manage uncertainty associated with

1. The economic downturn
2. The impact of government energy efficiency initiatives
3. The growth of electric vehicles
4. Local development hotspots etc

It is an effective mechanism, provided that further clarity is developed into the licence conditions to reflect the treatment of DNO either outperforming or underperforming the 20% threshold around the boundary and the mechanism for Ofgem to allow / disallow costs in this area e.g.

1. A DNO that has not delivered its load related outputs, and has under spent its allowance by 19% - would it get to keep the 19% ?
2. A DNO that has delivered its outputs, and has under spent its allowance by 21% - would it get the 1% clawed back or 21% ?
3. A DNO that has delivered its outputs, but been required to efficiently spend 19% more than the allowance, would it get no further allowance ?

4. A DNO that has delivered its outputs, but been required to efficiently spend 21% more than the allowance, would it get the 1% additional or 21% ?

Items 1 & 3 are the extreme positions of DNOs behaviour associated with delivery / non delivery of outputs. A formal mechanism should be in place in the licence to differentiate between these two behaviours in terms of allowances.

Question 3: Do you agree with the proposed mechanisms (reopeners/logging-up) for dealing with uncertain costs?

We believe that there is merit in the general approach to dealing with the uncertain costs of Critical National Infrastructure (CNI Site Security), HILP and Black Start (CBD). Improvement in the following particular points should be considered as part of the development towards final proposals

HILP (Central Business Districts)

We consulted extensively with our customers associated with the CBD provision in the 3 cities affected in our area, and there was an overwhelming view that these cost should be socialised across all our customer base for the wider regional benefits this would bring. We do not see any benefit in further consultation in this area.

We feel that the low level of investment for our areas to achieve the necessary improvement should simply be allowed as an ex-ante allowance in the Final Proposals (SPM £1.6m, SPD £1.0m)

CNI Security

Our CNI security is driven by our interpretation of the intentions of CPNI that we are one of only 4 companies identified as having "Critical National Infrastructure" (SP, SSE, EDF & NGC). These companies were identified by the CPNI by looking at substations supplying city centres, petroleum and gas installations etc. The drive is to ensure security from terrorism that may disrupt the stability of the country.

Given the senior level of these security discussions in government, we intend to implement any recommendations; as mandated, without further stakeholder consultation. Given Ofgem's reservations over the cost & risk balance regarding benefit to customers, it may be appropriate that their concerns be raised through intergovernmental department dialogue.

Black Start – (Emergency Batteries)

We support Ofgems view that a further clear steer from the E3C committee is required in 2010 prior to developing further plans in this area.

Rising Mains & Laterals

We welcome Ofgems approach to allow partial (ex-ante) funding for rising and lateral mains, with a full review & re-opener in 2013 of costs, ownership and responsibilities. Ofgems sensible and pragmatic approach reflects the high level of risks faced by ourselves, and other DNOs, against a perceived backdrop of uncertainty of responsibilities in this area.