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Dear James,

Consultation on the Draft Losses Discretionary Reward Guidance Document

Thank you for providing the opportunity to respond to the above consultation. We have reviewed the proposed Guidance document and believe that this covers the essential components of the Losses Discretionary Reward proposals. We would however, like to provide feedback which we hope will be taken into consideration.

We welcome the proposed evolution of focus for each tranche of this incentive as this takes into consideration the fact that, external factors driving network losses and DNOs' ability to understand them, may change across the ED1 period. For example:

- DNOs' ability to utilise Smart Metering information to understand network losses will be dependent upon their network achieving sufficient Smart Metering coverage, this is not something that DNOs can directly control and it is likely that this will vary materially across DNOs; and
- The uptake of low carbon technologies may increase network losses and are likely to vary materially across DNOs as the example of renewable generation demonstrates.

It is important that the mechanism can be refined to respond to such uncertainties.

We do agree that the first tranche should take a forward looking approach, however, this should also be regarded as an opportunity to assess DNOs existing approach to losses as we believe that a baseline must be established and critiqued for which future tranches can be measured against.

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It is important to recognise that DNOs will have differences in network losses due partly to differences in system design and differences in the nature of the customers that DNOs serve. For example:

- The SP Manweb interconnected network was designed to operate at a higher utilisation factor than the equivalent radial network which results in higher variable losses; and
- Large renewable generators are contributing to the decarbonisation of the electricity industry but in many circumstances increase distribution network losses; and
- Each DNOs network has developed over many decades to serve the particular needs of its customers; and
- One of the most significant factors driving network losses is customer energy consumption and particularly the timing of this relative to overall demand on the network.

It is important that there is consultation on the development of focus and criteria for future tranches so that the mechanism can be refined to respond to new information.

In considering the four assessment criteria we have provided the following views:

Understanding of losses

We agree that this is an essential first step, but believe that the expectations should take into account the status of the Smart Metering roll out, for example, the latest available information is that the DCC will be only be live in October 2016.

Effective engagement and sharing of best practices is an important area.

Consideration needs to be given to engagement with Transmission System Operators in light of the licence obligations on both DNOs and TSOs to "*permit development of an efficient, co-ordinated and economical system*". It is important that a holistic view of the combined transmission/distribution system is considered. For example, the area of voltage control is one where issues have developed due to the increase in the embedded generation connected to both systems.

DNOs are already engaging with TSOs to explore the technical solutions. A variety of solutions will be considered, some of which will involve the directing of reactive power flows in order to manage the system voltage. Such schemes may give rise to an increase rather than a decrease in losses, but considered as a whole may still represent the best value to the customer. It is important that due cognisance is taken of efforts to identify and evaluate new initiatives, even if ultimately the schemes selected lead to an increase in losses but represent overall efficient design, or schemes are rejected as a result of cost benefit analysis which indicates them to be uneconomic.

Process to manage losses

We agree that companies should be encouraged to actively consider and incorporate best practice in losses management. They should demonstrate the steps that they are taking, but as outlined above, it is important that DNOs should not be penalised for any increases in losses incurred due to

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schemes required to resolve issues on either their own distribution or transmission system, or resulting from simply serving the changing needs of new or existing customers.

Innovative approaches

The need to provide details of specific proposals is clear.

The process for assessing the submission against the four criteria is clear. What is not explicitly explained is whether the term 'innovative' applies to proposals undertaken by an individual company evaluated against its own baseline or against the performance of sector leaders. We believe that assessing Companies against their own baseline more accurately reflects the effects of their proposals whilst maintaining a healthy information exchange within the sector.

The assessment process is clear, however, it would be useful to understand how the sliding scale will operate and particularly the different treatment of DNO Licensees and Groups in this process. We think there would be merit in considering the approach stakeholder engagement as a model.

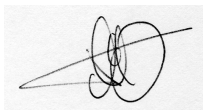
We believe further thinking and development is necessary in relation to the allocation of the available reward for successful DNOs. For example:

- if there is potential for a single DNO Group to receive the total available reward then this is likely to undermine any spirit of co-operation. We believe there are lessons to be learned from the experiences of the DPCR5 Broad Measure of Customer Satisfaction, where the relative nature of the measure discouraged DNOs from collaboration; and
- it would be useful to understand how the reward will be determined when this falls below the maximum available amount.

I am keen to be involved in any industry workshops that Ofgem may be planning following this consultation and will contact you directly to discuss your plans, and what contribution we can make to these.

In the meantime please do not hesitate to contact us should you have any queries regarding the points in this letter.

Yours sincerely,



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