

FAO Chris Chapman
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Ofgem's Three-year Strategy 2003-2006

Dear Chris

Thank you for the opportunity to respond to Ofgem's Proposed Corporate Strategy dated 16 December 2002. We would once again reiterate our support for ongoing consultation from the Regulator in planning future strategies. Comments from East Midlands Electricity are detailed below.

Key challenges facing the industry

The Networks Issue and Distributed Generation

RPI-X regulation has had a significant impact in delivering cost efficiencies to the benefit of customers. Within these frameworks EME continues to believe the most significant issue facing the industry is the long-term sustainability of energy networks. The key factors in the development of the RPI-X framework to support the development of sustainable networks will be delivered through clear objectives and deliverables, investment incentives balancing risk and rewards and in reducing the levels of regulatory and political uncertainty to DNO's.

We are encouraged by Ofgem's recognition of the "time of considerable change" in relation to distribution operators. A transition from lowest cost operation of passive networks to NGC type active network operation to meet future security of supply and environmental objectives would require significant review to investment levels for DNO's.

We would like to reiterate the points raised in our previous response to the letter of the 10th July 2002 in relation to environmental targets. We believe that the government's ambitious environmental targets are only likely to be met by a substantial increase in the amount of generation connected to distribution networks. Significant development of distribution networks will be required in order to accommodate this, and Ofgem will need to consider the best arrangements for incentivising distributors to facilitate distributed generation whilst maintaining

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existing levels of network performance in the longer term, as well as appropriate levels of risk for the businesses.

Competition in Connections

EME continues to be supportive of Ofgem's drive to introduce competition in connections, and we recognise that much useful work has been done so far. However, as stated in our letter of the 20th January 2003 to Sean O'Hara, we believe that there are a number of fundamental issues which need to be resolved before we will have a robust framework for competition in connections on which we can build.

We believe strongly that the ESQC Regulations must be compatible with Ofgem's framework for competition in connections, and that at the root of this are the arrangements for adoption and accreditation of contractors. A sound accreditation process will help the DNO determine whether the assets it is considering adopting are likely to be ESQC compliant, although our experience to date, which we will share with Ofgem, suggests that the current accreditation process is not sufficient.

We also believe that a DNO must have the right to refuse to adopt assets it reasonably believes to be non-compliant with the ESQC Regulations. If the DNO's design and specification standards are in line with the Regulations, and it carries out its inspections to determine compliance, then it should be able to make a reasonable decision on whether or not to accept the network.

Jim Tame's letter to Callum McCarthy in June last year contained strong legal arguments regarding Ofgem's proposals on the adoption of third party assets, and we believe that these concerns have not yet been satisfactorily addressed. We believe that the way forward is a voluntary adoption process, supported by a sound legal framework.

We feel that the time is now right for Ofgem to host a distributor workshop on Competition in Connections in order to understand the key issues and hopefully begin to identify sensible options for their resolution. As always, EME would be committed to seeking a positive outcome which would lay lasting foundations for the new competitive connections market.

New Distribution Licence Holders

EME is supportive of competition where appropriate, but we believe there are a number of issues that continue to raise concerns regarding licence applications, as set out in our letter of the 25th November 2002 to Michael Fews. We would still like to see a Regulatory Impact Assessment regarding the introduction of distributed asset ownership in electricity, as we are concerned that the benefits to customers are likely to be limited.

We are concerned that there are significant issues pertaining to customer service, safety and liability issues that remain unresolved. We also believe that further consideration needs to be given to the application of appropriate licence conditions to new distribution businesses.

We would also like to see appropriate arrangements in place to deal with a distribution business that ceases trading. We believe that the consequences resulting from the failure of a DNO would be substantially more complex than is the case with a supply business, and that a lack of arrangements for distributor of last resort would result in considerable disruption and confusion to customers.

DR4

We welcome Ofgem's approach in its industry involvement in the evolving DR4 review in giving increased visibility to distribution operators in the development of the price control. We would continue to encourage and support further involvement of industry stakeholders in the price control review process.

It is clear that the forthcoming electricity distribution price control review is significant and presents challenges for both the regulator and the industry. The progress and level of interaction between DNOs and Ofgem as a result of Ofgem's working groups is encouraging. However, time constraints are clearly quite pressing and we anticipate significant progress in the next consultation paper on the framework of network monopoly price controls. EME is supportive of the consultation process and will participate fully.

We also support the need to establish principles, such as those set out by the Better Regulation Task Force (transparency, accountability, consistency, proportionality and targeting) and the importance of maintaining a balance between risk and expected rewards.

Action required by Ofgem

East Midlands Electricity is supportive of Ofgem's development of efficiencies and effectiveness through cost reduction attributable to further implementation of effective resource management and cost controls. EME would like to see the scope of such controls extended to include Regulatory Impact Assessment of major issues, to ensure that areas of work are not undertaken without a proper understanding of the benefits customers will see, and the likely costs of achieving them.


Changes to existing work

As we have highlighted above, EME believes that the major focus for Ofgem must be the development of the long-term sustainability of energy networks. In delivery of this sustainability, due consideration needs to be given to the best means of facilitating the anticipated rise in the level of distributed generation that networks will be expected to accommodate. This should form the backdrop to Ofgem's work programme, as this area will have significant impacts across a wide range of additional areas.

We still have serious concerns regarding the development of Competition in Connections, as described above. However, we believe that following responses to Sean O'Hara's recent letter to distributors, it would now be appropriate for Ofgem to facilitate a workshop to get clarity on the outstanding issues, and to begin to plot a sensible way forward for the industry.

Should you wish to discuss this response in any further detail, please don't hesitate to contact me on the number or email address above.

Yours sincerely



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Regulatory Strategy Manager

CC PJE