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Dear Andrew

Regulation of New Electricity Distribution Licence Holders

We welcome the opportunity to respond to the consultation on the modification of standard licence conditions for new electricity distribution licence holders. We understand that Ofgem's proposals relate only to distribution licenses that will be granted to new electricity distribution licence holders. That is, the modifications do not effect the distribution licences that have already been granted to Scottish Hydro-Electric Power Distribution Ltd and Southern Electric Power Distribution plc or other existing distribution licenses.

We support the rationale behind Ofgem's intention to amend the standard licence conditions for new distribution licence holders in order to safeguard the financial stability of the licensed company and, therefore, the interests of consumers. We believe that Ofgem's proposal to, in effect, transfer Standard Licence Condition (SLC) 43 (Restriction on Activity and Financial Ring Fencing), 44 (Availability of Resources), 45 (Undertaking from Ultimate Controller), 46 (Credit Rating of Licensee) and 47 (Indebtedness) from Section C to Section B in new Distribution licences will achieve this.

We note that proposed new SLC 54 (Credit Rating of Licensee) allows for the Authority to accept a credit rating for a new distribution licensee that is other than an investment grade issuer credit rating. We do not believe that this is necessarily appropriate and could, we believe, be contrary to the provision for Section 8A 6(b) of the Electricity Act 1989 since the provision for alternative arrangements is not allowed for in the equivalent condition within Section C of existing distribution licenses.

We support Ofgem's proposal to introduce comparative price regulation for new distribution licensees. However, we do not believe that it is appropriate for price controls

to be imposed through the standard licence conditions. In our view, proposed Standard Condition 50 will be fundamental to the economics of new distribution businesses and therefore, if comparative price regulation is to be introduced, it should be a special condition of these licences.

Notwithstanding this, we have some specific comments on the proposed drafting of SLC 50:

1. We are concerned that the limitations of this standard condition are not always appropriate. Certain networks with unique connection characteristics, such as direct connections to NGC or networks with abnormal configurations, could well mean that, in order for the new network to be viable, Distribution Use of System (DUoS) charges would need to be higher than those charged by the licensed distributor with Distribution Services Obligations. We therefore believe that the proposed condition should only apply to networks connected to the local distribution system under a standard configuration where customers are metered at 11kV or below.
2. Although paragraph 3 allows for the Authority to consent to charges that exceed the DUoS charges to equivalent domestic customers, we are nevertheless concerned that this does not afford the new licensee sufficient security against the activities of the licensed distributor with Distribution Services Obligations. For example, a rebalancing of distribution charges by the “incumbent” distributor following a price control review, or a change to internal policy, could have a significant impact on the revenue stream of a new distribution licensee. We therefore believe that unless it is specifically protected against, a risk of this kind could distort competition and ultimately undermine the incentive for new distribution licensees to invest in new networks. This issue has been recognised in respect of proposals for comparative price regulation for independent gas transporters and although not yet resolved, proposals have been made that include a cap/collar protection mechanism within which comparative pricing would operate. We therefore believe that more specific protection against significant charge fluctuations should be afforded to new distribution network licensees.
3. We also note that the drafting of paragraph 3 refers to specific components of distribution use of system charges, that is “standing charge, unit rate and any other component part shall not exceed the distribution use of system charges to equivalent domestic customers”. We are concerned that this drafting limits the way in which a new distribution licensee can structure its charges to that of the incumbent distributor. We do not think that this is appropriate. Rather, we believe that the intention of the obligation should be to restrict the final use of system charge of new distribution licensees to ensure that they it would be comparable to the equivalent final distribution use of system charges to equivalent domestic customers.

Finally, we are concerned that in consulting on the proposed new distribution licenses, Ofgem has relied upon the publication of an open letter. In future, where modifications are being proposed to licence categories eg distribution, transmission, supply etc, we would request that Ofgem also write individually to each existing licensee within that

relevant licence category. This is particularly important given that under the Utilities Act failure to object to changes is taken as consent for the purposes of voting on licence amendments. Against this background, it is vital that the process is clear and transparent and we believe that this requires notification to all individual licensees.

I hope that you will find the above comments useful. In the meantime, do give me a call if you would like to discuss any of the points we have made in more detail.

Yours sincerely

Rob McDonald
Group Regulation Manager