



Aquila

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Our Ref: AKP/PF  
Your Ref

9 May 2003

Andrew Walker  
Ofgem  
9 Millbank  
London  
SW1P 3GE

Dear Andrew

### **Regulation of new electricity distribution licence holders**

I am pleased to provide the views of Aquila Networks plc ("Aquila") on the issues raised in your letter dated 16 April.

Aquila supports the equitable regulation of all licensed electricity distributors, as far as is necessary and reasonable. Consumers should be entitled to a minimum level of service and appropriate regulatory safeguards, irrespective of whether they happen to be connected to an ex-PES or new distribution network. It is also in the interests of consumers and other market participants that network operators are viable and have a stable financial profile. As such, Aquila supports the proposed Quality of Service and Financial Ring-fencing obligations.

### Charging Arrangements

The proposed charging arrangements raise a number of issues, which we raised in our response to your consultation last May. These revolve around the structure of charges (e.g. boundary between connection and use of system, 'Postage Stamp' Pricing, move from tariff support to full cost contributions) and possible market distortions. These remain unresolved and will need to be addressed as they will inevitably crystallise at some point in the future. I have appended our previous comments for your reference.

## Process

We agree that it is appropriate to apply the provisions of section 8a of the Electricity Act 1989 (as amended), in terms of modifying standard licence conditions when granting a licence to a new distributor. However, we are surprised that a statutory consultation notice has been issued at this time, since the requirements of the Act are for the process to be applied on an individual, case by case basis. We do not believe that the legislation provides for the automatic introduction of a generic Electricity Distribution Licence 'Version II'. Each application for a licence must be considered on its merits.

Whilst it is perfectly acceptable for Ofgem to set out its general policy, it is essential that the provisions of the Act are upheld.

## Standard vs special licence conditions

We also believe that the proposed Standard Condition 50 'Charging Arrangements', should more appropriately be introduced as a special licence condition. Licence conditions that regulate a licensee's revenue should always be subject to the individual consent of the licensee, rather than collective modification. This issue was rehearsed and accepted by Ofgem when the IIP incentive scheme ('special condition G) was introduced in April 2002.

I hope our comments are helpful and should you wish to discuss any particular point, please contact Paul Finch of my office on extension 05 2964.

Yours sincerely,

PF

**For A K Phelps  
Regulation Director**

## **Extract from Aquila response to Ofgem open letter May 2002**

### **Charging Arrangements – possible issues**

- Boundary between Connection and Use of System

To act in a non-discriminatory manner with other customers, we would charge a private network owner a UoS charge based on a similar sized demand customer. This would be a standard non-domestic tariff. The UoS revenue available to a private network owner would, therefore, be the difference between this and  $x$  (where  $x$  is the number of premises) times our standard domestic tariff. The total income available to the private network owner would be this plus any connection charges. The owner would need to adjust their connection charges to ensure they obtained a reasonable return from their investment. Depending on the level of UoS charges that the private network owner may recover, the connection charges may not equate to the actual cost of providing the assets. This would be inconsistent with Ofgem's stated intent of moving away from 'tariff support' to full cost connection charges. It would impose an artificial boundary between connection and UoS charges. As the host network licensee would not be constrained by such an artificial boundary the connections market would be distorted, sometimes to the private network owner's advantage and sometimes to the host network licensee's advantage.

- 'Postage Stamp' Pricing

At present all distributors operate on the basis of 'postage stamp' charges i.e. all customers of similar characteristics are charged the same irrespective of both the location within a host network's service area and irrespective of the customer processes. If private network owners are to be limited to charging the host network's UoS charge and have a consistent connection charge policy, then they may argue that the host network should charge them a lower or disaggregated UoS charge. Without abandoning the 'postage stamp' principle, disaggregation is only possible between different published tariffs such as domestic/non domestic or HV/LV. As tariffs are not structured based on inclusion or not of private network assets, this will distort the market in network provision to those cases where this difference in tariffs is sufficiently large to provide a return for the private network owner, i.e. 'cherry picking'. In practice this will be private networks with a large number of customers or with a high density and, therefore, low cost per customer.

- Full Cost Contributions

Ofgem have indicated that they would wish to remove tariff support and move to full cost contributions at the next price control. The implication of this would be for lower UoS requirements on private networks (to cover operating and maintenance costs only). In these circumstances, the price differential between domestic and non-domestic may be greater than required and result

in cross funding between the host network and the private network owner and inappropriate higher returns for the private network owner.

Clearly if these issues are to be avoided the structure of UoS charges will need to be carefully examined. We believe that any move away from 'postage stamp' UoS would result in unacceptable costs to consumers and would not support it. It is possible that a clearer boundary definition between connection and UoS and re-balancing between unit and fixed charges may accommodate private networks, but are of the view that the potential for distorted market signals is great if changes are not carefully examined. Any interim proposals should therefore be a very short-term measure, with a full analysis of the impact undertaken and this should be incorporated into the existing Structure of Charges review.