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Developing Network Monopoly Price Controls, EME Response to Initial Consultation

Dear Cemil

This letter outlines the response of East Midlands Electricity to the Ofgem Consultation Paper "Developing Network Monopoly Price Controls: Initial Consultation" dated August 2002.

SUMMARY OF EME'S POSITION

The development of the framework for the next distribution price control review should encompass, and be carried out in conjunction with, many other related work streams. Obligations and incentives on distributors will need to be balanced to ensure the best outcome for both present and future consumers in terms of network integrity, appropriate quality of service, price stability, environmental considerations and also the government's energy policy guidance.

The coincident timing of the energy policy review is opportune. The PIU and others have already recognised the dangers of a myopic focus on reducing costs and investments. Consequently the RPI-X framework needs to be developed, retaining the cost efficiency driver whilst ensuring that security of supply, fuel poverty and environmental objectives are also adequately incentivised. A risk based asset management approach is the best way forward and Ofgem's move to assess companies' asset risk management processes is a step in the right direction that is welcomed.

It is clear that levels of security of supply will deteriorate unless appropriate levels of investment, based on network needs, are made. In addition, the desired move to active networks and distributed generation needs significant work by all players to ensure adverse effects are minimal and energy delivery is not compromised. It is important that both issues are properly addressed in the review.

It is imperative that the price control framework provides clear objectives and deliverables to DNOs over the longer term. Periodicity of risk and returns gives weak incentives to invest in network assets due to uncertainty beyond each five year price control period, and this needs

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to be addressed by the provision of network investment incentives which allow companies to properly balance risk and reward over the life of the asset.

Successful asset management processes have enabled some companies to extend the life of assets and defer replacement whilst meeting performance and safety requirements, but they have also exposed the underlying deterioration of network assets and increasing level of risk. Moreover, the bow wave in investment to replace assets constructed in the 1950's and 1960's is simply being deferred. Recent investment profiles have replaced only a small fraction of the network infrastructure and asset replacement timescales can now be measured in hundreds of years. As a result, the network will become more prone to failure and less able to accommodate the necessary growth in distributed generation.

These major issues can be addressed by utilising companies' improved asset management expertise to properly identify and fund long term network needs, developing incentives on delivering the government's challenging distributed generation objectives, enabling steps towards a more active operational role for distributors, and continuing to focus on meeting deliverables in an efficient and effective way.

EME agrees broadly with Ofgem's principles, aims and objectives as set out in the consultation paper. EME's aspirations would be for:

- clarity of objectives and deliverables for DNOs
- fair assessment of proposed options for meeting deliverables
- transparency in modelling and analysis
- focussed information requirements, and
- a framework that has clear incentives and properly deals with uncertainty.

In addition, any comparison across companies needs to be equitable. The process of developing reporting under IIP has highlighted the gross inconsistencies and inaccuracies in reporting in the past and, therefore, comparison of historical performance data has been demonstrated to be fundamentally invalid.

It is our view that Ofgem's initial consultation document is a good start which the proposed working groups can build on. EME is supportive of the intent to stimulate innovative and honest debate in these groups and will contribute fully.

The initial high level objectives look sensible, and we concur with the underlying criteria of:

- enabling both Ofgem and companies to meet their statutory and licence obligations;
- providing appropriate quality of service to both present and future consumers;
- ensuring system security and asset integrity;
- and allowing a reasonable return to capital providers.

Finally, EME are keen to participate fully in the development process and whilst acknowledging Ofgem's good intentions, we also recognise that there are significant challenges and would like to emphasize the importance of not losing sight of the principles and objectives as time constraints become more pressing.

SPECIFIC COMMENTS

CHAPTER 2 OFGEM'S PROPOSED APPROACH TO UNDERTAKING PRICE CONTROL REVIEWS

Paragraph 2.2

EME support Ofgem's intention to make any financial models public domain. Transparency is important and it would be useful to be involved in the development of any financial model, perhaps by having workshops at key stages. It is imperative that the treatment of interest and

tax costs is explicit in the model so that the impact of the price control on the key credit rating ratios can be assessed. In particular, the model will need to take proper account of the changes in treatment of capital expenditure for tax purposes, which come into effect from 1 April 2005, details of which have been recently sent to you via email.

Whether the steps identified in paragraph 2.4 are appropriate;

The steps outlined in paragraph 2.4 look to be appropriate, however we would also expect an appraisal of information requirements and how any information collected will be utilised. It would be prudent to ensure that collection of further information complements rather than overlaps with that already collected annually (IIP, LTDS, RAs, ARM), and that the process is focussed to relieve the burden on both companies and Ofgem, whilst allowing best use of information available. EME would be happy to input into development of an information provision framework to best support the necessary analysis.

An additional step would be to evaluate and review the methodology and principles, which underpin the assessment of efficiency and the treatment of that efficiency. It is not expected that a definitive method can be developed in phase I of the DNOs price control review process, and this aspect may need revisions at each future price control review to account for changes.

What information should be published as part of the review process;

All relevant information should be published as soon as is practicable. This would include:

- timely consultation papers
- all responses and a summary of responses
- guidance Ofgem receives such as that from the Secretary of State on social and environmental issues
- reports from consultants on work commissioned both directly on the price control review and on related issues
- decision making process and an explanation of how views have been taken into account
- summaries of key issues debated in working groups
- any models developed at key stages of development, such as financial models
- use to be made of information collected, and
- details of methodologies, for example, for assessing efficiency, as they become available.

In addition, we would expect timely responses from Ofgem to specific correspondence by DNOs, collectively via the EA, or individually.

The approach to identifying the objectives, principles and key issues for the price control review;

Ofgem has set out initial high level objectives and key issues for the price control review in their initial consultation paper. The initial high level objectives look sensible, and, as already expressed, we concur with the underlying criteria of:

- enabling both Ofgem and companies to meet their statutory and licence obligations
- providing appropriate quality of service to both present and future consumers
- ensuring system security and asset integrity, and
- allowing a reasonable return to capital providers.

EME supports the proposed evaluation of the 2 key issues listed, but would add more; these are listed in specific comments under chapter 4.

Obligations and incentives on distributors will need to be balanced to ensure the best outcome for both present and future consumers in terms of network integrity, appropriate quality of service, price stability, environmental considerations and also the government's energy policy guidance.

EME's aspirations would be for clarity of objectives and deliverables for DNOs, fair assessment of proposed options for meeting deliverables, transparency in modelling and analysis, focussed information requirements and a framework that has clear incentives and deals with uncertainty.

Identifying price control principles, such as how to assess the efficiency of companies, setting of quality of supply targets and the approach to financial issues, needs to be part of the consultation process and be included in discussions in the relevant working groups.

It may be valuable to hold a small number of workshops split into small groups as per the intended working groups in order to establish objectives, principles and key issues for the price control review.

What considerations should be taken into account in specifying outputs;

As outlined in the paper, outputs can cover a number of areas, in addition to those mentioned, the price that consumers pay and the quality of service that companies deliver, we would add the area of risk and long-term network integrity. Although we recognise that some of these outputs are difficult to measure their importance is reinforced by Ofgem's survey of asset risk management processes. The relationship between quantifiable measures such as: asset age, number of faults, inspections data, and condition, risk of failure, performance and residual life, is complex. However, by using and developing tools such as our condition analyser and performance analyser, EME have made significant progress in this area. Significant consideration is needed of the long-term effects of monitoring specific outputs and, more importantly, incentives on those measures.

It is encouraging to see that Ofgem's working groups include discussion on assessing customers' willingness to pay for improvements in quality of supply. The lack of evidence of customers' willingness to pay was used to counter arguments for a symmetrical incentive scheme under IIP.

It would be useful to understand Ofgem's intentions on how information from any customer research would be used to inform the development of the price control review framework and what weight would be given to customer preferences in relation to other information such as assessment of efficiency, asset risk management survey and government policy. Some thought needs to be given to what information would be useful, i.e. what can companies and Ofgem positively respond to, what are reasonable options, based on what is technically achievable, to give to customers, what would be the objectives, and how to ensure a robust methodology to take account of views of a representative sample of types of customers and regional variations.

It is important to bear in mind that, customers relate to their own recent experiences and tend to want an improvement from the current position. It is therefore important to establish what the customer considers to be the baseline and to understand how to translate individual expectations into averages, such as CMLs and CIs.

As Ofgem is aware, it is not possible to offer customer specific services in electricity distribution. However, it is unlikely that a survey will show a consensus of opinion on all issues across all customers and regions. The resolution of conflict needs to be addressed. For example, in the 1999 survey commissioned by Ofgem, two thirds of domestic customers were willing to pay a median value of between £5 and £11 for specific improvements whilst one third were not willing to pay for those specific improvements. Furthermore, conflict between network needs, government policy and customer preferences may be an issue, for example, customers may not be willing to pay for the investment needed to accommodate the government's target levels of renewable energy and associated active networks, or longer term network security.

In any survey the depth of understanding of the 'product' determines the quality of the responses. It should be noted that the majority of consumers are not aware of long term investment issues or risks of short term gain, i.e. unsustainably low prices now may necessitate high recovery costs should the current levels of system risk and performance be allowed to become unacceptably low. Therefore, societal value of energy delivery systems for both present and future customers may be better assessed elsewhere.

The approach to establishing the appropriate incentive framework;

EME supports the view expressed in the paper that the incentive framework must protect the interests of present and future consumers while allowing companies to finance their licensed activities.

In order to effectively incentivise companies, clarity is needed in a number of areas such as the treatment of efficiency savings in this period and the next.

We are supportive of the intention to review the effect of the periodicity of the price control and the possible advantages of setting longer-term output targets, more aligned to the long-term nature of distribution businesses.

Paragraph 2.21 and 2.22

Increased annual collection of data and improvements made in consistency and accuracy of reporting and associated guidance, such as that relating to IIP and set out in the RIGs and the RAGs, are welcome improvements and should go some way to easing the burden on regulated companies. EME would welcome further clarity and guidance relating to the completion of the Regulatory Accounts, particularly with respect to the method of apportionment of costs (activity analysis) and capitalisation policies. However, it would not be of benefit to have guidance which is too prescriptive or detailed since this would only result in the annual provision of information becoming too onerous.

The balance between clear guidance to ensure focussed, accurate and consistent data provision, and something that is so prescriptive that data collection becomes disproportionately onerous, is an important consideration in collection of data. Furthermore, any data collected from external parties, such as energywatch, etc. needs to be the product of robust processes consistently applied. We support Ofgem's intention to allow companies adequate time to comment on draft versions of main information requests and consider it essential that reasons for collecting information and uses of the information are established prior to data collection.

In this process it would, of course, be prudent to ensure that collection of further information complements rather than overlaps with that already collected annually (IIP, LTDS, RAs, ARM), and that the process is focussed to relieve the burden on both companies and Ofgem, whilst allowing best use of information available. EME would be happy to input into development of an information provision framework to best support the necessary analysis.

The way in which the price control review process should be assessed.

The assessment of the price control review should compare the outcome against the high level objectives and principles. EME supports the review process outlined, allowing views of all concerned to be considered. However, it is only possible to judge the success or otherwise of the review once the period to which it applies has elapsed, i.e. 2010.

It will also be necessary to provide a mechanism for taking into account, at the review stage, any relevant developments, such as changes in legislation and industry structure.

CHAPTER 3 REVIEW OF EXISTING NETWORK MONOPOLY PRICE CONTROLS

Whether there are any areas of inconsistency in the present price controls where greater consistency would benefit consumers;

EME is supportive of Ofgem's proposal to review areas of concern expressed by interested parties, such as the NAO and BRTF, etc. EME is supportive of the UK's regulators' proposed joint study on the cost of capital, particularly on the degree of consistency and on identifying the most appropriate approach, having regard to current best practice, for estimating the cost of capital for regulated utilities.

The most appropriate approach to dealing with concerns regarding the periodicity and strength of incentives provided to companies to achieve efficiency savings, including whether companies should be allowed to retain efficiencies for a fixed period of time regardless of when the saving is made;

EME is supportive, in principle, of the treatment of capital expenditure efficiencies proposed at the last price control review, being the retention of efficiencies for a fixed period of five years regardless of when the saving is made and provided quality of supply targets are met. In principle, EME believes it is important to balance the incentives to make savings in operating and capital expenditure. Extending the proposed treatment described above to operating cost efficiencies could be a way of achieving this. However, EME would welcome further clarity on how the proposed treatment will be applied, and in particular details of:

- the mechanism for adjusting income after the elapse of the retention period
- the process for dealing with expenditure incurred in excess of allowances where this makes economic sense or is outside the company's control, for example where this is driven by customer requirements
- the calculation of and the mechanism for ensuring adequate allowance for costs incurred to achieve efficiency savings, and
- the process for setting allowances against which efficiencies will be judged.

The most appropriate way of assessing companies' efficiency including:

- **whether a total cost model could be used to mitigate concerns regarding the distortion of incentives between operating and capital expenditure;**
- **whether quality should be included when assessing efficiency and if so, how;**
- **the impact of corporate transactions and changes in industry structure on the way price controls are reviewed and implemented, and in particular on the type of benchmarking (of both costs and quality of service) that can be carried out and the issues that need to be considered in making these comparisons;**

EME supports evaluation of more joined up total cost quality assessment and use of equitable benchmarking techniques. We recognise significant challenges such as the need for robust normalisation, which needs to address increases in costs incurred as a result of replacement cycles, improvements in customer service, delivery of future efficiencies or in response to customer requirements. Focussed asset management processes may have allowed deferment of investment in the past but eventual replacement requirements will need to be factored into any total cost solution.

We welcome the consistent and accurate reporting introduced under IIP, which is a step in the right direction. However, the process of developing reporting under IIP has highlighted the gross inconsistencies and inaccuracies in reporting in the past and, therefore, comparison of historical performance data has been demonstrated to be fundamentally invalid. However, it is notable that EME requested no change to their targets due to a change in measurement systems. We believe that we have implemented 'best in class' reporting and measurement systems for the past decade, which have significantly influenced our asset operation and management processes to the benefit of our connected customers. This should be recognised.

The reported performance of all companies influenced the price control and its acceptance. The targets set at the last Distribution Price Control Review were based on companies' performance relative to each other as well as the extent each company has improved its own position over the period since privatisation. However, it is now apparent that the industry's historic performance was unclear, and consequently the rankings used to set CML and CI targets are incorrect. It is not ideal that significant performance benefit has been based on these. We accept that it would not be in anyone's interest to retrospectively assess the decisions that underpinned DR3, however, we believe that a more robust understanding must be taken into account in the next price control review, with its links to asset risk management and allowances.

EME supports the evaluation of issues of comparative analysis and assessment and treatment of efficiency savings in relation to changes in industry structure. In particular, it is essential to develop equitable treatment of merged and single companies in any benchmarking exercise, to ensure achievement of Ofgem's objective of allowing the market to determine the best structure.

The best way of ensuring that companies continue to have the right incentives to invest in a timely and efficient manner to provide a good quality of service to consumers and maintain system security and in particular looking at the relationship between capex and the RAV, including:

- **the way in which capex efficiencies are reflected in the RAV and how the regulator should monitor companies' performance on an ongoing basis to ensure that quality of service, asset integrity and system security are maintained;**
- **whether non-operational capital expenditure should continue to be excluded from the RAV;**
- **whether the process of setting capex allowances every 5 years creates distortions to companies' incentives to invest in the network and if so how these should be overcome. For example, should capex allowances be set for a longer period of time and what role does output monitoring and quality regulation play in this regard;**
- **whether there is a case for differential treatment of 'different categories' of capex. For example, are there differences in the risks that companies incur in undertaking different projects that mean the related expenditure should be treated differently in the RAV;**

It is imperative to have clarity and consistency in incentives and in treatment of efficiency. EME would welcome evaluation of the above issues.

The assessment of quality of service, asset integrity and system security is complex. However, the reporting requirements, such as IIP, together with the asset risk management survey and assessment of companies own asset management processes together with their inputs and outputs should provide a means of assurance that the company understands the network needs. The company should then be best placed to identify and cost options to manage the assets efficiently.

We welcome the proposed evaluation of the benefits of inclusion of non-operational capital expenditure in the RAV. Issues for consideration should include:

- the definition of non operational capex
- the life over which such expenditure would be depreciated
- the appropriate rate of return
- treatment of under/over spend, and
- treatment of other investments that lead to savings, such as restructuring costs.

It is imperative that incentives for investment are aligned with appropriate deliverables and the changing role of DNOs, for example, a move to active networks will involve investment of non-

operational capital expenditure for reasons other than efficiency. Furthermore, in assessing differences in risks that companies incur, due recognition should be given to past levels of investment and allowances in past price control reviews.

We would like to seek clarity on the treatment of metering in the rolling 5-year adjustment for capex. At the last price control review, there was no explicit metering capex but rather an overall allowance for the companies to manage efficiently.

Whether the approach taken to ensuring companies can finance their activities and estimating the cost of capital is appropriate given the possible scale and nature of future investment requirements in gas and electricity transmission and distribution that may be necessary to facilitate the growth of renewable energy.

Traditionally DNOs are seen as relatively low risk businesses and are required to maintain a stable level and trend of key financial ratios consistent with an investment grade credit rating. It will be necessary to ensure that the price control enables DNOs to continue to meet the required ratios. New risks should be recognised and appropriate mechanisms introduced to deal with new risks. Distributed generation is a major new challenge, which EME is embracing, whilst attempting to mitigate the risk. However, this should not overshadow other risks, such as changes in tax rules, street works, lane charging, insurance and the new electricity supply regulations.

As already stated, EME is supportive of the UK's regulators' proposed joint study on the cost of capital, particularly on the degree of consistency and on identifying the most appropriate approach, having regard to current best practice, for estimating the cost of capital for regulated utilities.

CHAPTER 4 THE NEXT DISTRIBUTION PRICE CONTROL REVIEW

The initial objectives that Ofgem has identified for the price control review and in particular how outside influences should be reflected in these in a way which is consistent with the statutory duties and obligations of Ofgem and the DNOs;

In addition to the objectives listed in 4.9 and 4.11 we would propose adding:

- 'minimise the burden and cost of the price review process'
- 'seek to ensure that DNOs are financed to take account of network stewardship to balance short, medium and long term performance', and
- 'undertake appropriate cost benefit analysis of any new initiatives'.

Ofgem's initial thoughts on the key issues for the price control review;

The paper lists only 2 key issues, which are 'dealing with uncertainty' and 'developing the regulatory framework to deal with increased levels of distributed generation'. EME concurs with the need to address the issues listed, and would like to add the following:

- developing long term incentives/focus on network investment based on condition
- how to reward and assess efficiency
- tax rate adjustment to allow for the change in tax treatment, and
- further developing output measures and targets

The most appropriate form of the incentive and price control framework;

Fundamentally, the form of the incentive and price control framework should allow the objectives to be met, and, therefore, incentivise DNOs to deliver appropriate outputs at appropriate prices.

We support evaluation of DNO deliverables, incentives and price control framework and welcome the forum for debate provided by the recently established working groups.

The development of the framework for the next distribution price control review should encompass, and be carried out in conjunction with, many other related work streams. Obligations and incentives on distributors will need to be balanced to ensure the best outcome for both present and future consumers in terms of network integrity, appropriate quality of service, price stability, environmental considerations and also the government's energy policy.

Although RPI-X regulation has been successful in driving costs out of the business, with allowed incomes more than halved over this period, it has been recognised that there are risks associated with such a short term focus. Both the PIU and NAO made comments pertaining to the need for sustainable investment: "Continued attention to long term incentives is required" (PIU) and "Regulators should encourage network companies to develop risk management models to assess the potential impact of deterioration in asset performance on future levels of service" (NAO).

The efficiency frontier approach may not be an appropriate mechanism in future price control reviews, given the change in objectives and deliverables to enable active management of distributed generation together with a robust infrastructure to allow energy delivery for current and future consumers.

Significant changes, in the industry and externally, have taken place since the last price control review and these must be taken into account in developing the price control framework. For example:

- the need to ensure network integrity for future customers, which was missing at DR3, has been acknowledged
- the need to deal with uncertainty appropriately, particularly but not exclusively, distributed generation
- Ofgem's increased social and environmental responsibilities
- the introduction of further competition in the areas of connection and metering, and
- the need for equitable comparison across companies has been highlighted by the introduction of accuracy and consistency in reporting under IIP.

Network integrity for future customers

We welcome Ofgem's initiative to review companies' asset risk management processes, which could then be used as part of a robust methodology for allocating capital allowances. EME strongly believe that in order to judge the effectiveness of asset risk management, account needs to be taken of both the inputs and outputs to the process together with the effectiveness of prioritisation and delivery. Therefore in any assessment of the overall effectiveness of a company's asset risk management, judgement must be made against this wider perspective.

It is EME's view that, although improved asset management techniques have allowed levels of network investment to be minimised in the short term, without any perceivable change in asset resilience, our work in this area indicates that these investment levels are not sustainable. Since privatisation EME has had the lowest investment per customer and has managed their assets accordingly. It is possible to extend asset lives for a short period, but the need for replacement is not eradicated. To ensure long term stewardship of the network, it is imperative that a more appropriate way of allocating capital allowances, to that at the last price control review, is undertaken.

We were encouraged by the suggestion at the Ofgem workshop (28th May 2002) that companies' own methods for assessing network needs could be assessed rather than producing a generic model of a virtual benchmarked company. EME have discussed their views of capex modelling at length and appreciate the time Ofgem have given to these discussions. Equally, we appreciate being given the opportunity to demonstrate tools, developed in-house, for analysing network performance and asset condition, together with risk

assessment techniques and our risk register. We believe we have robust processes and systems for assessing both the effects of current levels of spend, and necessary future levels of investment for maintaining security of supply in the long term.

Distributed generation

Distributors facilitate energy delivery within the regulatory framework. The energy policy review presents many challenges, particularly in relation to the changes necessary to facilitate the level of renewable energy required to meet the government's targets. Distribution deliverables need to be redefined accordingly. Any transition from lowest cost operators of a passive network to delivering energy solutions and operating actively and embracing environmental objectives is a multi-year journey, which can only be achieved with carefully developed incentives.

The level of investment required to enable connection of large volumes of distributed generation is dependant upon the nature of operation of that network and the available means of ensuring security of supply, i.e. constrained operation with traditional back up or unconstrained operation. Initial analysis shows that moving from a passive network to an active network, managing high volumes of unconstrained distributed generation, necessitates investment levels that are orders of magnitude more than those required to move to the accommodation of constrained distributed generation.

EME welcomes the opportunity for DNOs to discuss issues in the recently established working groups on the structure of distribution charges and dealing with uncertainty. Any changes in the structure of charges should not distort the balance between risk and reward.

EME is supportive of the use of distributed generation to meet the government targets on renewables. It should be recognised, however, that distributed generation is not necessarily renewable, and renewable energy may not need to be connected to the distribution network. For example, CHP is not necessarily renewable and large offshore wind may be more economically connected to the transmission system. In developing any incentive mechanism, it should also be recognised that some regions may more easily accommodate both distributed and/or renewable, by nature of the region itself and the inherent network characteristics. To meet government targets a significant contribution will be required from all Distributors and targets and incentives may need to be aligned with the natural potential for each area. It may not be prudent to incentivise connection of renewable/distributed generation, when it is inappropriate, inefficient or, indeed, impossible to introduce high levels in all regions.

Finally, we appreciate the need to develop robust incentives, to facilitate meeting the government's targets on renewables and to enable fair competition in generation, however it should not be to the exclusion of incentives to ensure necessary sustainable investment in the infrastructure. We should not lose sight of the fact that the majority of electricity will still come through traditional routes for some time.

Social and environmental outputs

Clearly, increased levels of renewable energy fall under this category as do network losses. However, clarity is needed in relation to possible development of additional output measures and we would welcome information on guidance received by the Secretary of State, on social and environmental issues, as soon as is practicable.

In particular, we believe that visual amenity issues concerning the network need to be addressed in the review. We have a major national park, the Peak District National Park, and numerous areas of natural outstanding beauty (ANOBs) in our area, which impact on our existing and new network. The future design of networks in these areas will be part of the challenge of the longer-term stewardship of the assets, and we will need to take account of the views of other stakeholders, i.e. the Peak District Joint Planning Board.

Competition in connections

EME is supportive of the development of competition in connections, which should lead to more choice for customers. We want to work with Ofgem to establish effective means of allowing third party contractors to develop connection assets that will meet Network long-term requirements. A statutory framework, which provides for appropriate obligations and safeguards for distributors adopting the completed asset, is required. To date the dialogue on Connections has been unsatisfactory and we welcome the recent offer of further dialogue from Richard Ramsay in his response to Jim Tame.

Metering

EME have been supportive of the development of competition in metering and it is important that mechanisms to develop the metering market do not penalise Distributors. Investment in metering assets has reflected customer need and fulfilment of the obligations required by the regulator. Accounting for those assets has also reflected these regulated obligations with long term depreciation policies. Transition to a competitive market place must at the very least be based on modern equivalent asset principles. Further consideration also needs to be given to the best mechanism for assigning provider of last resort and allowing Distributors to pursue meter "sell only" options in the future.

Equitable comparison

The area of inherent or inherited network differences is extremely complex. EME has developed a significant understanding of the issues surrounding the normalisation of quality of supply outputs, and welcomes being a member of Ofgem's working group on this topic. We believe that full normalisation of quality of supply outputs may be impossible to achieve. We are of the opinion, however, that an equitable process can be developed that will facilitate improved understanding of the differences in companies' quality of supply performance. This understanding will assist more appropriate targeting of investment at the periodic price controls.

Equally, it is imperative that due consideration is given to the differences in investment levels over the last three price control reviews.

The initial high level timetable for the price control review and in particular the possible impact that external events may have on the timing of the major deliverables and when decisions can be taken about key aspects of the price control.

Development of the price control framework presents significant challenges and it is important that objectives and principles are not compromised by the time constraints. The timetable of work looks sensible, however, it is important to keep all related work streams in line, since issues such as normalisation have a significant influence on other areas, such as benchmarking.

Furthermore, we would agree with the need to allow an appropriate amount of time to respond to consultation documents, in line with Ofgem's recently published policy, and to complete information requests.

CONCLUDING NOTE

The initial consultation document sets out the challenges and range of work for the next three years. EME recognises the challenges and stresses the importance to this review of the issue of network stewardship.

We believe that the initial consultation document is a good start to a challenging process. We are supportive of Ofgem's proposed process for developing network monopoly price controls,

in particular Ofgem's working groups are seen as an important forum for debate and exchange of ideas in several key areas and EME are keen to participate fully in such debates.

I would be happy to discuss the views expressed in this response in more detail, if you wish to do so or wish to seek further clarification please contact me via email or telephone, on 01332 393301.

Yours sincerely

Paul Eveleigh
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