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Mr Cemil Altin,
Ofgem,
9 Millbank,
London,
SW1P 3GE

17th September 2002

Dear Cemil,

Developing network monopoly price controls – Initial consultation

Thank you for allowing us the opportunity to respond to the above consultation. The following comments represent the views of TXU Energy (TXU) regarding the issues raised in the document.

TXU welcomes the steps taken by Ofgem to make the process more transparent. It is important to make the process as open as possible through the use of workshops and seminars among other forms of communication. As well as the Distribution Network Operators (DNOs), this will allow interested parties such as Suppliers and consumers to become more informed and get more involved.

Set out below are the issues that TXU consider to be the most important in considering network price controls in the future.

Approach for the Price Control

The generic approach to price controls is well established having been used in previous price control reviews in both the gas and electricity industries. It is important to use this in conjunction with a realistic financial model to assess the viability of the licensee. This approach has been successful previously and does not need to be amended. However, one issue specific to the next Distribution Price Control can be examined again. Improvements in in-situ diagnostics means the lifetime of most assets have been extended and therefore the value which to ascribe to depreciation should be adjusted.

Assessment of Efficiency

Clearly there are still some efficiency gains to be made by many of the DNOs. However, it is vital that the right incentives are provided to encourage a greater quality of service, particularly because distributed generation will become increasingly important over the next few years. The assessment of the efficiency of companies should be as detailed as possible and a greater balance of incentives between Capital (Capex) and Operating expenditure (Opex) will

provide greater clarity. The blurring of Capex and Opex could be addressed by assessing efficiency on the basis of a measure of total cost.

Providing the Right Incentives

TXU believes that a greater symmetry in the ‘cap and collars’ of financial incentives would encourage better performances from network operators. Customers should not have to pay the network operators huge incentives for providing a service that they should be providing anyway. Deeper ‘collars’ on incentives should be applied more consistently and incentives should be more symmetrical. However, there should be scope for network operators to respond to market signals, within a price control period, should there be demand for it.

TXU agrees that the periodicity of price controls may distort incentives. Ofgem need to provide incentives that will encourage investment in the later years of the price control either by allowing retention of efficiency savings for a fixed period of time, or introduce a rolling 5-year treatment of Capex.

A vital element of the work must also be to ensure quality and security of supply *while taking into account future demands on the system*. While monitoring output and quality of supply in the present is important, it is imperative that DNOs are not given scope to make efficiency savings now that have a detrimental impact upon the integrity of the network in the future. This is especially important with the likely acceleration of distributed generation connections during the next price review.

The Next Distribution Price Review

The step change required in distributed generation connections, to meet the Government’s renewable energy targets, will lead to a greater amount of uncertainty over the next few years. Quality of supply is likely to be more important to customers yet will be more threatened by them. However, increased connectivity and better access to information for Suppliers could help mitigate some of this risk. Although, in conjunction with this, there needs to be further strengthening of the financial ring-fencing surrounding vertically integrated network companies. A burden of proof should be placed upon these companies to ensure that they are not discriminating against third parties nor providing undue benefit to their affiliates.

Finally, there have been a number of mergers between several network operators over the past few years and there are still many efficiency savings to be made through these mergers. However suppliers and consequently customers have yet to see these synergy benefits.

Should you wish to discuss anything further, please do not hesitate to contact me.

Yours sincerely,

Haley Hutson
Competition & Pricing Manager