



Aquila

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28 June 2002

Andrew Walker
Director – Regulation & Financial Affairs
Ofgem
9 Millbank
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Dear Andrew

Regulation of Electricity Distribution Licence Holders

I refer to Ofgem's open letter published in your name and am pleased to provide the comments of Aquila Networks ("Aquila"), (formerly GPU Power Networks (UK) / Midlands Electricity).

We agree with Ofgem that it is in the interest of consumers that use of system (UoS) charges to domestic premises on a private network be limited to that which would be charged by the host network. Energy networks are by definition a local monopoly business and it is important that consumers are protected from overcharging for UoS. Market entry by private network operators should also be on an economic basis, such that other networks are not disadvantaged and to avoid a possible distortion in a competitive connections market.

However, Aquila believes that Ofgem's proposal in respect of UoS charges could have significant impacts on the pricing structures of electricity distribution and before any firm decisions are taken, must therefore be considered in more detail as part of Ofgem's Structure of Charges Review. Our initial concerns are outlined later in this letter.

In view of the strategic, economic and social importance of energy networks, Aquila believes that as a principle, 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 private network. This will usually be a matter outside of their control. It follows that as far as is reasonable, network operators should therefore be subject to a common set of obligations, including

quality of supply. It is also important that network operators are viable and have a stable financial profile. Aquila therefore supports the proposed obligations in respect of Quality of Service and Financial Ring-Fencing.

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.

I hope these comments are helpful and have copied this letter to Colin Green who I understand is responsible for the Structure of Charges review.

Yours sincerely,

A K Phelps
Regulation Director

Cc. Colin Green