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Dear Gary,

Regulation of a new electricity distribution licence holder - Letter of 24 September 2003

Introduction and general comments

British Gas Trading (British Gas) welcomes the opportunity to respond to Ofgem's consultation in respect of 'Regulation of a new electricity distribution licence holder'. British Gas has an interest in the outcome of this issue because of our presence in the electricity market.

This non-confidential response can be placed in the Ofgem library.

Ofgem proposals

Charging arrangements

British Gas agrees that it is appropriate, for an interim basis only, for domestic customers' charges on new distributors' networks to be set by reference to the charges of the ex-PES Distribution Network Operator (DNO) within that service area. The appropriate enduring form of regulation for these charges should be price controls set on the basis of the efficient level of costs of serving those customers. British Gas would be concerned if the proposed interim arrangements were left in place for any significant period of time as this could perversely incentivise ex-PES DNOs to restructure their charges on a non cost reflective basis to foreclose the market to new entrants.

It is not clear what arrangements apply to the customers of ex-PES DNOs operating out of their service area. Are the charges capped at the level of the ex-PES DNO whose service area the customers are connected (as for new entrants), the DNO's own (different) price control levels or are the charges uncapped? As a minimum these domestic customers should be afforded some form of price cap protection, ideally this should be the same as for new entrants.

Financial ring fencing etc

The proposals in this area are generally welcome. However, the Authority will need to exercise extreme caution in relation to any discretion it chooses to exercise with regards to alternatives to the obligation to maintain an investment grade credit rating.

Any alternatives need to afford no less financial protection of the licensee, hence customers, than the current default arrangements.

As these interim arrangements will eventually lead to price controls for all distributors it would appear appropriate to extend the provisions of regulatory accounts to new entrants at this time. This should also ensure that any consents given by the Authority to allow charges to be higher than the ex-PES DNO in that area can be verified on an ongoing basis via consistent cost allocation information.

Other existing Section C licence conditions

Conditions 39, 40 and 41

Beyond distribution activities, customers should be protected via effective competition. The introduction of the Utilities Act formally separated the competitive supply activities from the monopoly distribution activities. These changes were brought about to remove any perverse incentives for the monopoly distributor to discriminate in favour of its own supply business. Similar arrangements were earlier brought about in gas following an Ofgas referral to the MMC. Most commentators agree that this is the minimum form of regulation to facilitate effective supply competition. These arrangements are effectively implemented via restrictions on the use of distributor information, the appointment of a compliance officer and the prohibition of cross-subsidies.

The protections currently afforded to existing domestic customers connected to the networks of ex-PES DNOs via the various licence conditions referred to above should be extended to the domestic customers of new entrants.

If you have any questions please do not hesitate to contact me on the number given above.

Yours sincerely

Tahir Majid
Regulatory Issues Manager