SP Transmission & Distribution

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Your ref

Our ref

Date
13 September 2004

Contact/Extension

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Dear Donna

Regulation of Independent Electricity Distribution Network Operators

I am writing on behalf of SP Distribution and SP Manweb in response to the above consultation paper issued in July 2004.

Our detailed comments on the paper are given in the attachment. A particular issue not mentioned in the paper is the relationship between the connections boundary and restrictions on DUoS charges for IDNOs. It is important that the basis for charge restrictions of IDNOs is consistent with the connections boundary to avoid potential distortions of competition in distribution. Discussions over the connections boundary in the ISG forum and its implications for independent networks therefore need to be taken into account in developing regulatory arrangements for IDNOs.

I hope that this is helpful, but please contact me if you would like to discuss further.

Yours sincerely,

Jeremy Blackford
Regulation Manager
SP Transmission & Distribution

SECTION THREE: BACKGROUND

1. We agree that a long term regulatory framework for IDNOs should be implemented as soon as practicable in order to improve transparency of network regulation and to reduce uncertainty for network operators as a whole. We also agree with the objectives set out in paragraph 3.22 regarding promotion of effective competition, efficiency and economy in distribution systems.

2. It is important that long term arrangements for IDNOs avoid any artificial stimulus to the growth of independent networks arising out of the link between the connections boundary and charging restrictions. It would clearly distort competition in distribution if IDNOs were able to charge twice for the same assets – once from connection and once from use of system - due to the way that their charge restrictions were constructed.

3. Current proposals for the connections boundary imply that assets that do not represent reinforcement of the existing distribution network should be treated as connection. If applied to independent networks, this could give scope for IDNOs to subsidise connections from use of system charges, depending on the basis of charge restrictions and any links to DNO charges. Arrangements for charge restrictions on IDNOs need to address this.

4. It is also important that any proposals take adequate account of any increases in costs to the parties concerned, for example to accommodate changes to contractual arrangements.

5. We agree that DNOs operating out of their distribution service areas should be subject to the same regime for charge restrictions as IDNOs.

SECTION FOUR: CONTRACTUAL ARRANGEMENTS

Use of system charges

6. We see no case for amending the contractual framework so that the supplier pays each of the network operators for use of system. The upstream DNO will have no visibility of the use of his system by a supplier to customers on a downstream network. Even if such data were available, the DNO would need to have different sets of DUoS charges and line loss factors covering each pair of voltages involved. Incremental costs to DNOs of implementing these changes would need to be recovered in charges to users. Suppliers would need to make changes to their systems in order to accommodate such billing arrangements, and would seek to recover the additional costs involved from their customers.

7. To suggest aligning charging arrangements in electricity with those in gas also fails to take account of the differences in charging structures between the sectors, and also the much simpler infrastructure levels in gas. We are at a

loss to see any benefits to customers or to competition from the changes in systems and the increased costs to all parties concerned that would be involved. Existing arrangements whereby the DNO charges use of system to the downstream network operator should therefore be retained. Contrary to what is said in paragraph 4.9, under existing arrangements the IDNO will not collect DUoS charges on behalf of other distribution businesses downstream, but will pay the DNO for use of the latter's network.

Metering

8. Boundary meters are needed for purposes of transparency of charging and for measuring distribution losses, as set out in paragraph 4.15, but are not required for settlement purposes.

Quality of service

9. In order to avoid potential distortion of competition in distribution, we would expect to see similar requirements in respect of quality of service for all distribution network operators.

SECTION FIVE: CHARGE RESTRICTION ARRANGEMENTS

10. Arrangements for charge restrictions should take account of the connections boundary. DUoS charges mainly recover the costs of providing an infrastructure. For IDNOs, the majority of their assets are likely to be connection, particularly given the current position of Ofgem on the connection boundary. Accordingly, there is a risk of distortion of competition if IDNOs charges are capped against the host DNO's charges, as this could allow IDNOs to charge for the same assets twice, once via connection charges and once via DUoS charges.

11. To address this issue, we support option B i.e. RPI-X regulation based on the IDNO's costs, with benchmarking used as appropriate. The DNO's charges could act as a supplementary cap, but should not act as the main restriction.

12. Account also needs to be taken of potential distortions to competition where adoption payments for networks constructed by third parties are no longer being made. In such cases, the ICP could have a commercial incentive to auction the network to the highest bidder. This could in turn provide an artificial stimulus to the growth of IDNO networks unless appropriate charge restriction arrangements to avoid double charging were applied.

SECTION SIX: FINANCIAL RING-FENCING OF IDNOs

13. The main principle here should be that similar arrangements should apply to all licensed distributors, in order to avoid the risk of distortion of competition.

14. We can, however, see a case for recognising the difficulty that smaller companies may have in obtaining an investment grade credit rating. It is not clear, however, why the threshold should be as high as 500,000 connected supply points – i.e. around 2% of the GB total. We agree with the comment in paragraph 6.26 that the cash in escrow or bond arrangements mentioned in paragraph 6.21 should cover six months operating costs including use of system liabilities to the host DNO.

15. In paragraph 6.22, it is not clear how the parent company of the licensee could be required to offer the IDNO networks for sale in the event that it did not replace money drawn down from the escrow account or bond by the IDNO concerned.

16. Other financial requirements, including regulatory accounts, ring fencing and indebtedness, should be the same for new operators as for DNOs.