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Dear Mark

Regulation of Independent Electricity Distribution Network Operators

CE Electric UK Funding Company (CE) is the UK parent company of Northern Electric Distribution Limited (NEDL) and Yorkshire Electricity Distribution plc (YEDL). This letter represents the response of CE, NEDL and YEDL to Ofgem's Initial Proposals publication, on the Regulation of Independent Electricity Distribution Network Operators.

We continue to support Ofgem's moves to deliver robust regulation of this emerging market. As we have stated previously, it is our belief that this process should move rapidly to provide clarity as to how all participants in the market should behave.

In summary, we are broadly in agreement with Ofgem's views on the way forward for the regulation of IDNOs. Our views on the key areas are given below:

- Proposal 1 is a pragmatic starting point for determining the charging arrangements, but mechanisms should be put in place to enable it to be reviewed;
- DUoS charging restrictions should apply to all IDNO charges, not just the domestic market;
- The proposed financial ring fencing arrangements are incomplete in that they do not consider the situation where a company with investment grade credit status fails. There should be parallels with the arrangements recently announced for suppliers;
- Alignment of commercial arrangements in the gas and electricity markets should be pursued only where positive benefits have been clearly identified;
- The marginal cost of providing boundary metering over and above the provision of isolation equipment is minimal and therefore should be applied to **all** connections; and
- The IDNO network should be considered as one customer from the DNO's perspective, particularly with respect to the application of quality of service reporting and targets.

Our fuller views on the areas identified within the consultation are given below.

Charging Arrangements

The start date for the price control should be April 2006, as implementation from either April or September 2005 would not give sufficient time for consultation and overcoming any practical issues of implementation. This also represents a low-risk option, as the existing arrangements, where the IDNO charges are capped at the incumbent DNO charges, can

continue in the intervening period with reduced uncertainty for IDNOs as the incumbent DNO DUoS charges for 2005/06 have now been published.

We support Ofgem's view that the start point of the control should be the incumbent DNO's charge. However, whilst we recognise the argument that directly controlling charges to domestic premises only will lead to indirect regulation of charges to all premises, through the undue discrimination rule, we are still of the opinion that the charge restrictions should apply to all customers, not just domestic.

It is our belief that policing this rule would lead to significant investment of regulatory effort in validating IDNOs' charging methodologies, and the resultant tariffs, to verify that they are non-discriminatory. As DUoS charges make up a relatively small proportion of customers' bills, it is unlikely that they will be sensitive to any distortion inherent in their DUoS charges. The option that yields the greatest benefit for least cost, whilst protecting the interests of all consumers, seems to be simply to control directly charges for all premises.

A useful mechanism for this has been provided by the means through which Ofgem have constructed the price control for meter asset provision. This is very specific in terms of the construction of the price caps for certain, including domestic, meters, whilst specifying a generic formula for non-specified meter types. A similar approach could be applied to the form of control for IDNOs, with specific licence conditions being applied to the pricing for domestic customers, with more broadly applicable conditions being applied to the remaining customer groups.

The proposal put forward (Proposal 1) that seeks to cap and collar IDNO charges within a percentage tolerance of the DNO starting charge is, at least in the short term, a pragmatic way forward. Our main concern would be that, over the medium to long term, there needs to be a facility for this to be reviewed, both on a market-wide basis (if in the light of experience there are unintended consequences arising in the operation of the market) and also on a participant-specific basis, to ensure that no individual company is exploiting the mechanism at the expense of cost reflectivity to customers.

To ensure consistency of treatment, it is our view that nested networks should be treated in the same way as a downstream network on an incumbent DNO network, with the start point of the control being the upstream IDNO charges.

Financial Ring Fencing

Clearly, any discussion on cover is likely to be contentious, particularly where it may involve cash sums being locked into escrow accounts. It is therefore useful that the proposals present a valid case for continuing the current arrangements.

Where the proposals appear to be weak is in respect of the failure of companies that have achieved the status of not requiring escrow or cash bond facilities, i.e. they have achieved investment grade credit rating or a keepwell arrangement.

It could therefore seem rational, particularly given the effort that has been expended, to consider whether cover arrangements being applied to suppliers going forward should be applied to IDNOs who are trading under these circumstances.

Commercial Issues

With respect to aligning the trading arrangements for gas and electricity we are of the view that this requires careful consideration from both a cost / benefit and from a practicality perspective.

Ofgem have requested specific details of costs in this area. The current basis upon which this can be provided flows from the implementation of the BSC Modification Proposal P62. The relatively minor changes implemented have facilitated the separation of the GSP Group

from the Distributor and allowed a one-to-many relationship, for a cost in the region of £160,000.

Costs of facilitating transition to gas arrangements would arise in a number of areas:

- Central BSC systems;
- Supplier and their agents' systems – for example Data Collector and Aggregator systems would have to be amended, as would supplier billing systems;
- Distributor systems – particularly billing; and
- Entry testing.

These changes would inevitably be much more complex than those carried out to implement P62 and, therefore, are likely to be very costly. Should there be a desire for this to be pursued, Elexon could carry out a preliminary feasibility study. This could lead to a full impact assessment via the appropriate BSC and MRASCo change management processes.

Metering at the Boundary

Given that there will be a requirement for some form of isolation equipment between the IDNO and other networks, it seems self-evident that the marginal cost of installing metering at the boundary point is small. We, therefore, re-iterate our response to the open consultation that metering should be installed at the boundary to **all** connections.

For safety, we would require that the connections boundary be established at the entrance to the development. There are clear and present dangers in having cables under multiple ownership in the same footpath. We welcome Ofgem's view that this point of connection should be provided with appropriate protection and disconnection facilities to protect the rest of the public network.

The prime reason for requiring such metering is to maintain the integrity of settlements. The issue is one of ensuring an appropriate attribution of apparent losses, where a key factor will be the accurate registration and metering of exit points from the total system. If even one set of normal domestic premises on the IDNO system were not properly registered, it would increase apparent losses by over 3MWh p.a.

Given that the ultimate exit points from the IDNO system will be metered, boundary metering can be considered as providing a view of the apparent losses associated with that network. Arguments have been made that the materiality of these apparent losses is of a similar magnitude as the consumption associated with unmetered supplies and that metering is therefore not required.

As the Electricity (Unmetered supply) Regulations 2001 require metering above 500W, generally, to be fitted it is clear that the consumption of one un-registered domestic property is in excess of this. It should also be noted that it is less than the LV losses we would normally associate with developments of more than 6 or 7 houses with gas-fired heating. Losses are therefore material for any significant development, and justify consideration of metering.

We can also compare the cost-effectiveness of metering at the boundary with that of metering street lighting and similar connections. Most street lighting schemes above 500W are connected via a kiosk with a suitable cut-out and metering. This clearly provides a safe and economic solution for these low-consumption supplies, and there is no reason why this should not also be the case for even the smaller domestic IDNO developments.

For larger developments that require a new substation (whether or not entirely dedicated to the new development), the incremental costs of providing boundary metering should be no more than for smaller developments. We would need a slightly larger building, and to revise the LV cabling, but this does not represent a significant technical obstacle.

It is clear that the appropriate metering solution should not incur significant costs in data collection and processing. We would propose that the appropriate solution is, therefore, HH MOST (half-hourly metering outside settlement timescales), requiring no more than a monthly visit by an appropriately-equipped meter reader.

Quality of Service

Our view remains unchanged in that where there is a single connection to an IDNO network it is no different to other connections to a DNO network and as such is a single customer. This is of particular importance when considering the application of the IIP RIG's, which if the IDNO customers were counted individually would lead to double counting of them in the IDNO and the DNO returns.

I hope that you find these comments helpful. If you would like to discuss any of them, please do not hesitate to contact me.

Yours sincerely

Joe Hart

Network Sales Manager

CE Electric UK