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Our Ref RA/CN/32.0
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Mark Cox
Distribution Policy
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Ofgem
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Date: 18 March 2005

Dear Mark,

Regulation of Independent Distribution Network Operators – Initial Proposals Document

I am writing to you, on behalf of EDF Energy regarding the January 2005 Consultation Paper on the above subject.

Given our extensive interests in generation, supply and networks (both public and private) we have a great interest in the outcome of this consultation process and welcome the opportunity to comment on it. Our key points on the issues raised in the document are summarised below with our more detailed comments contained in the attachment to this letter:

- We do not support the alignment of the electricity contractual arrangements with those utilised in gas, as we believe it would result in increased prices to customers connected to IDNO networks;
- In determining the required assets, at the DNO/IDNO interface, each DNO must not only ensure that it complies with the ESQC regulations but with all its relevant statutory obligations. This means that the asset requirements for any connection are necessarily determined on a site specific basis and that, in some circumstances, duplicate assets will be required;
- The majority of non domestic customers have no more market power than domestic customers and hence must be similarly protected. Consequently, we believe that non domestic customers should be included within licence condition BA1;
- We remain of the opinion that boundary metering is essential, as without it cost reflective charging cannot be achieved;
- We believe that the ring fencing mechanism could be improved by including a specific cash lock up mechanism in standard condition BA6 which should be based on the conditions set out in SLC 47; and

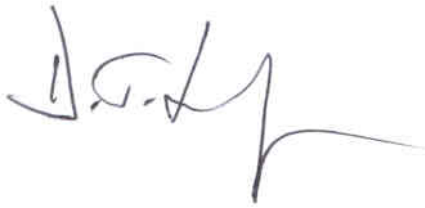
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- We believe that in the short term the relative price control mechanism (Proposal 1) is the better option for protecting customers, on IDNO networks, from being disadvantaged. However, in the longer term we believe that Proposal 2 may have merit as it would focus regulatory effort on the costs under the control of the IDNO.

I trust you will find these comments helpful. If you have any questions please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'D. Linford', with a long horizontal flourish extending to the right.

Denis Linford
Director of Regulation

EDF Energy Response to Regulation of Independent Distribution Network Operators – Initial Proposals Document

Proposals for IDNO charging arrangements

The prime consideration in determining the appropriate charging mechanism must be that customers should not be disadvantaged by being connected to an IDNO network instead of to the incumbent DNO network. Having considered the options outlined in chapter 5 of Ofgem's paper, we believe that at this stage Proposal 1 fulfils this criterion better than Proposal 2.

We are, however, concerned that the outcome of the review of IDNO charges in 2011 will only apply to new sites connected after that date. This means that any reduction in charges, resulting from IDNO efficiency improvements, would not be passed on to such customers for ten years. On this basis, IDNO customers are being treated differently from DNO customers, in that the latter receive the benefits of DNO efficiency improvements after five years. In our view, therefore, any IDNO efficiency savings must be passed on to these customers in 2011.

In the longer term, Proposal 2 has merit in that it would focus regulatory effort on the proportion of the cost under the control of the IDNO. We agree that it would be sensible for the costs of the incumbent DNO to be treated as a pass-through cost by the IDNO. This would align the treatment of the DNO charges with NGC exit charges in the ongoing distribution price control. However, we also believe that the proposal could be improved by including a condition that the total charge to the customer would continue to be capped at the incumbent DNO charge. This would protect the customers from being charged more than if they were connected to a DNO network, but also allow them to benefit from cheaper prices if IDNOs are able to deliver distribution services at a lower cost.

Treatment of non-domestic customers

We believe that standard licence condition BA1 should be extended to specifically cover non-domestic customers. Ofgem suggests (see paragraph 5.41 of the paper) that most non-domestic customers should be in a position to engage in connection agreements themselves. However, this will not be the case for the majority of small non-domestic customers, who will have no choice over their distribution services provider and hence have no more market power in this area than domestic customers. Consequently, we believe that the same level of regulatory protection currently enjoyed by domestic customers should be extended to non-domestic customers.

Treatment of nested networks

We do not support the proposal that nested distribution networks should be treated in the same manner as those in the gas sector. If a network is transporting energy, which is not required for customers connected to it, the operator must be remunerated to compensate for the provision of the additional capacity and for the running costs that providing this service entails. Not to do so would mean that charges would be neither fair nor cost-reflective, as one distributor's customers may end up paying additional costs that should be borne by another distributor's customers.

Financial ring-fencing issues

We are largely content with the financial ring-fencing regime established for IDNOs under standard licence conditions BA2 to BA6. In our view, the provisions of this regime are robust and proportionate, having due regard to the differences of scale, financing, and resourcing that seem likely to remain in place for the foreseeable future between IDNOs and the incumbent DNOs. It is important in this debate to acknowledge the prospective benefits and safeguards provided by the new backstop framework for administration orders under the Energy Act 2004 in relation to network operator insolvencies.

There may be merit, however, in providing further protection to the IDNO so that its parent company cannot take funds out of the licensee (except with the Authority's approval) if the parent is in financial distress. That is the rationale behind the new so-called cash lock-up regime which will take effect on 1 April 2005 as a modification to standard condition 47 of the DNO licence. We think that these new DNO provisions should be incorporated into standard condition BA6 for the IDNOs, and that the appropriate trigger event for a lock-up – as Ofgem has suggested – would be the failure of a parent company to meet a call for funds under its keep-well agreement with the IDNO.

Alignment of gas and electricity structures

Our position remains that the gas and electricity structures should not be aligned. The reasons for this are:

- **Transaction costs:** At Ofgem's recent workshop on IDNO regulation, a supplier representative highlighted that a move to the gas structure would increase costs to customers, as suppliers would face additional transaction costs associated with duplicate invoices. These costs would be passed on to customers. Consequently, customers connected to an IDNO network would be disadvantaged compared to those connected to a DNO network; and
- **System costs:** As we highlighted in our earlier response, the electricity industry systems have been structured so that suppliers receive only one invoice per MPAN. The alignment of our systems and processes with those used in the gas industry will incur additional costs. As such costs have not been included in the current DPCR settlement, we would expect to recover them from customers.

Therefore, it would appear likely that an alignment of the existing electricity structure with the gas sector will increase prices to customers. This is patently not in customers' best interests.

Equipment at the DNO/IDNO interface

We note the opinion of the DTI that only one point of isolation and protection is required to satisfy regulation 6 of the ESQC Regulations. However, as is pointed out in the consultation it is for each DNO to ensure that it complies with the Regulations. Therefore, where we believe issues of safety arise, from not having separate points of isolation/protection, then we will require such points to be established.

In deciding the appropriate assets for any connection, DNOs must satisfy a number of obligations (including, in particular, their duty under section 9 of the Electricity Act to develop and maintain a safe, efficient and economical system of distribution), not just those contained within the ESQC Regulations. In practice, this means that the asset

requirements for any connection are necessarily determined on a site specific basis and that, in some circumstances, duplicate assets will be required.

Where it is practicable for the DNO/IDNO to share a point of isolation/protection we agree that IDNOs could be allowed access to shared assets, installed on our sites, to enable their operation. This would be subject to the DNO being able to develop and implement appropriate operating procedures, an agreement covering the charging of any associated costs and legal contracts with the IDNO. However, in some circumstances we may not be able to allow shared access where sensitive loads (for example, hospitals, key governmental locations, and financial centres) are also supplied from the same site or there is insufficient space for all necessary equipment.

Additionally, on a number of sites, utilised by our licensed DNOs EDF Energy is not the free holder. In law, therefore, we would not be able to grant access of our own volition, as that is not a matter for the leaseholder. Therefore, as with decisions in relation to isolation and protection, decisions on allowing access to shared assets will also need to be determined on a site by site basis.

Boundary metering

We remain of the opinion that boundary metering is essential for all IDNO connections. The reasons for this are:

- **It facilitates cost-reflective charging:** The alternative would be to develop a commercial agreement covering volume allocation. In our view, such an approach would inevitably lead to disputes, which would impose ongoing costs on DNOs, IDNOs and Ofgem (since the Authority would ultimately have to determine such matters). We understand that boundary metering is not used in the gas sector, where volume allocations are used instead. However, we noted at Ofgem's workshop that at least one supplier felt that this arrangement did not work well and resulted in disputes, as Transco and IGTs could not agree appropriate volume allocations;
- **It allows losses to be correctly attributed to both the DNO and IDNO networks:** This is vital in view of the enhanced incentive to reduce losses placed on DNOs as a result of the new price control. It would be inappropriate for DNOs to be exposed to increased financial risk as a result of an incorrect allocation of losses between networks. In the longer term, boundary metering would also facilitate the setting of losses targets for IDNO networks; and
- **It enables Ofgem to collect more accurate information on units distributed to facilitate its comparative benchmarking approach to the price control regulation of DNOs:** The use of relevant information on a truly consistent and comparable basis for the purposes of such benchmarking is an important regulatory objective in its own right.

In addition, we believe it is inappropriate for an IDNO connection to be treated as an unmetered supply, as the load is unpredictable. It would appear that IDNOs' principal concerns are that the installation of boundary metering will impose unfair additional costs on them. However, as Ofgem points out in paragraph 7.31 of its document, the incremental cost of installing such metering, above that required for the unavoidable cost of housing protection/isolation equipment, will generally be relatively small. We acknowledge that, in certain situations, particularly at low voltage, new technical solutions may have to be developed to minimise the costs of metering. We are happy

to work with the rest of the industry to develop a solution to this and other issues, as long as the proposed solution does not conflict with us meeting our statutory obligations.

It should also be remembered that, at the interface between NGC and DNOs, the latter bear all the costs of the GSP metering. It is also normal practice on our network where energy is transported between DNOs for the recipient to bear the cost of the metering. The proposed treatment of IDNOs in respect of boundary metering is fully consistent with this.

IIP measurement issues

For incidents on the incumbent DNO network, which affect customers connected to an IDNO network, it would be more accurate for DNOs to include the total number of IDNO customers affected in their IIP reporting rather than treat them as a single customer. However, this would require the IDNO to provide the DNO with:

- Customer numbers at each connection point which are derived and maintained in line with the accuracy requirements required for the IIP. We would expect Ofgem to include such a requirement within the Quality of Service RIGs; and
- Information on the total number of customers connected to the IDNO network as at 30 September each year. This is essential as it would be incorrect for IDNO customers to be included in the numerator of the quality of service calculations but not in the denominator.

In addition, we would expect the IDNO to require the owner of any nested network to provide it with the relevant customer number information so as to enable the IDNO to fulfil the above obligations to the DNO.

EDF Energy plc
March 2005