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Dear Mark,

Regulation of Independent Distribution Network Operators

Thank you for the opportunity to respond to your initial proposals document on the above topic. SSE are broadly supportive of the proposals outlined within the document with regard to charging arrangements, financial ring-fencing of Independent Distribution Network Operator (IDNOs) and the commercial issues surrounding them. Attached is a note of our detailed comments on the proposals.

We do, however, continue to have one area of serious concern. This is in respect of Ofgem's apparent unwillingness to accept industry advice that the contractual framework within electricity necessarily differs from that in gas due to the more complex nature of billing and settlement. One of the key objectives of the recent industry-wide initiative undertaken to accommodate competition on new licensed distribution networks was to avoid changing the industry design baseline due to the significant costs such change would invoke. Ofgem were an active participant in the industry wide focus group that agreed this objective and have access to both the qualitative and quantitative information used to support this decision. We do not feel that further evidence on costs and benefits is required, as it is clear to industry members that such change is neither practical nor beneficial.

If you would like to discuss any of the points raised in our response please do not hesitate to call.

Yours sincerely,

Rob McDonald
Director of Regulation

Scottish and Southern Energy plc

Detailed Response to Initial Proposals Document 18/05

Proposals for IDNO Charging Arrangements

As indicated in our response to the July 2004 consultation paper (July'04 paper), we are broadly supportive of the use of a relative price control (RPC) mechanism for the longer term price control arrangements for IDNOs.

We would agree that a RPC based on the incumbent DNO's charges subject to a floor and ceiling would be the most appropriate of the options considered for the regulation of IDNO charging arrangements. However, tracking the incumbent DNO's charge to equivalent domestic customers would force the IDNO to match the tariff structure of the incumbent DNO. As competition develops an IDNO could own networks embedded within a number of different DNO areas. Maintaining different DUoS charging structures across these networks would place an unduly onerous burden on IDNOs and could inhibit the development of competition. As noted in our response to the July'04 paper, we believe that the RPC should be referenced to overall allowed revenue for the DNO not individual tariffs. This would allow each IDNO to develop the most appropriate tariff structure for its networks.

We are of the view that the start date of the review period for IDNO charge restrictions should be at the start of a Financial Year. We consider April 2006 to be the most appropriate start date as it avoids retrospective implementation or the potential distortions outlined in your paper. We do not believe that an April 2006 start date will result in significant uncertainty for IDNOs.

With regard to the period of control, we have previously expressed the view that price stability for new network developers is best obtained over the longer term. The period of control should therefore be, as a minimum, ten years and preferably twenty.

On the two additional issues raised in the paper. Firstly, we agree that the non-discrimination provision of SL4C provides adequate protection to non-domestic customers. Secondly, with regard to nested networks we believe that a charge for wheeling is necessary on intermediary networks to ensure the correct allocation of the cost of transportation.

Finally on the evaluation of options, and as noted in our response to the July'04 paper, we are supportive of a 'two tier' approach and would urge Ofgem to reconsider their views on this. We believe that a threshold around 500,000 exit points is appropriate and, as noted previously, could be justified by considering the statistical techniques used to model relative efficiency for the DNOs. This threshold is unlikely to impact any IDNO for a number of years but would nevertheless give a clear signal that they will be regulated on a similar basis to DNOs once they reach a comparable size.

Financial Ring-Fencing of IDNOs

We note Ofgem's intention to retain the financial ring fencing conditions in section BA of IDNO licences and the proposal to maintain the alternative arrangements to the requirement for an investment grade credit rating under BA5. As noted in our response to the July'04 paper, whilst we are generally supportive of these proposals, we see no reason to distinguish between credit requirements of IDNOs above the 500,000 threshold and those of DNOs.

We note that these proposals maintain the consistency with the financial ring fencing arrangements recently proposed for Independent Gas Transporters.

With regard to the whether or not a 'cash lock up' is appropriate for IDNOs, we believe that such a proposal will provide greater protection to customers. We agree that failure of the parent company to meet a call under the keep well agreement is the most appropriate trigger event for the cash lock up.

Commercial Issues

1. Industry Framework

We continue to be concerned over Ofgem's reluctance to accept that it is neither practical nor desirable to align gas and electricity structures in this context. We have indicated previously that the costs of such change would be substantial to the industry as a whole, with no obvious benefit to the consumer or to competition.

A significant amount of work in this area was carried out by the industry under the auspices of the Distribution Business Focus Group (DBFG) which culminated in changes to the MRA, BSC and SAS to facilitate competitive supply on the networks of new licensed distributors. The DBFG agreed that changes to the industry baseline design would significantly add to the costs of facilitating competitive supply to these networks. In particular it was accepted that for a supplier to receive more than one DUoS bill would entail significant change to industry systems, be prohibitively expensive and should be avoided. Ofgem took an active role in the activities of the DBFG. Information on the practical issues (and costs) involved in changing the contractual arrangements in electricity will therefore already be available to the Authority. We do not feel it is necessary to revisit this work or provide further evidence of the practical differences between the gas and electricity structures.

2. Boundary Equipment

We welcome the Ofgem/DTI view that Regulation 6 of the ESQCR can be met by ensuring there is a single protective device at a link point between a DNO and IDNO network, supported by appropriate operating/access arrangements. We further support the view that in the exceptional circumstances where licensees can justify the requirement for duplicate sets of protection, the IDNO should only be expected to pay for one set of equipment.

3. Boundary Metering

As stated in our response to the July'04 paper, SSE are of the view that boundary metering is essential in order to form the basis for DUoS payments and for price control purposes. We therefore welcome the fact that Ofgem are minded to support a requirement for such metering for HV connections and LV connections at a substation.

We note Ofgem's concerns over the relative costs of metering when the boundary is an existing LV line or cable. However, we do not believe there are likely to be many IDNO/DNO interfaces at these points and would therefore accept this as the *de-minimis* level without further assessment being required.

4. Quality of Service

We welcome Ofgem's proposals that the same Guaranteed Standards of Performance will apply to DNOs and IDNOs.

We are concerned, however, with the level of IIP reporting being proposed for IDNOs. Whilst we agree that all network operators should report annually on the number of customers connected to their network, CIs and CMLs, we are concerned over the proposal to disaggregate CIs and CMLs to a similar level required by DNOs. We feel this may place a disproportionate burden of bureaucracy upon IDNOs.

5. Other Commercial Issues

With regard to standard condition 4A of the distribution licence, currently a distributor must provide 3 months notice of any proposed changes to their charges for Use of System (UoS). Where the host DNO precipitates such a change, an IDNO would require notice of the former's indicative charges in advance of the 3-month period. This is impractical and we would suggest that the current 3-month licence condition remains on the host DNO only, with the downstream IDNO requiring to provide its revised charging statement, say, 2 months in advance. There is need for a similar relaxation if a DNO changes their final UoS charges up to 1 month prior the start of a Financial Year. In this instance we would suggest that the downstream IDNO be required to update its final charging statement by, say, 2 weeks before the start of the Financial Year.

Further consideration needs to be given over the advance notice required of nested networks.