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**BY E-MAIL**

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Dear Heather

**EDF ENERGY'S RESPONSE TO OFGEM'S APRIL 2006 CONSULTATION ON THE  
REGULATION OF INDEPENDENT ELECTRICITY DISTRIBUTORS: IMPLICATIONS OF  
LICENCE APPLICATIONS FROM AFFILIATES OF EXISTING LICENSEES**

Thank you for the opportunity to comment on the above consultation. I am responding on behalf of EDF Energy plc, including its licensed supply businesses and its three licensed distribution network operators (DNOs). I can confirm that this response can be placed on Ofgem's website. Please note that, while this response is made on behalf of EDF Energy as a whole, I understand that Ebbsfleet Valley Utilities is writing separately.

Ofgem's paper raises a number of potential concerns, one of which is common to all Independent Distribution Network Operators (IDNOs) and others of which are specific to IDNOs affiliated to a DNO. We discuss each of these potential concerns in turn below, together with the regulatory options that Ofgem has identified. We then make recommendations as to the appropriate regulatory action to be taken.

**Issue Common to All IDNOs**

Ofgem is concerned that under relative price regulation, IDNOs are incentivised to compete only for the "lowest cost network extensions" and that, as a result, the local DNO's average costs (and hence use of system charges) will rise to the detriment of its customers.

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(A) We agree that, under a regime of IDNO relative price regulation, such incentives exist, but would observe that, because of the relative size differences between DNOs and IDNOs, the effect on a DNO's average cost will be very small (a situation likely to persist for many years given the current and potential number of customers connected to IDNO networks). However, the incentive applies equally to all IDNOs, whether affiliated to a DNO or not; it is already a level playing field. The likely effect of applying a different form of price control to an affiliate IDNO is that the balance will be tilted in favour of the non-affiliate IDN, since its equivalent offering will be more competitive, which will therefore be selected by the developer. Such an outcome would provide no protection to the DNO's customers (the effect on its average costs will be the same) and would damage competition in the IDNO market by reducing the number of competing offers available to the developer.

Even under relative price control, the degree of competition between potential IDNOs does affect the end customer, through the combined effect of incentives to developers and competition in the development market. So, reduced competition, as a result of tilting the balance against an affiliated IDNO, will be detrimental to customers' interests, since the impact on customers connected to the DNO will be the same whichever IDNO wins the contract from the developer.

#### **Issues Specific to Affiliated IDNOs**

(B) Ofgem is concerned that affiliated IDNOs could receive preferential treatment or access to information, thus damaging competition in connections.

We believe that this is a valid concern, which is why EDF Energy already has in place internal controls (as part of its Competition Act compliance programme) in this area similar to those required under SLC39 with regard to the provision of information to energy suppliers and gas shippers. **We would support the appropriate codification of these controls into amended licence conditions, including a new licence requirement on DNOs not to restrict, prevent or distort competition in the distribution of electricity.**

(C) Ofgem is concerned about a DNO having the opportunity to divert low cost extensions to its affiliate IDNO, thus exacerbating the potential increase in the DNO's average costs.

We do not believe this to be a valid concern since the DNO is not in a position to merely assign inexpensive network extensions to its affiliate IDNO. Rather, it is the developer who chooses whether to appoint a DNO or an IDNO, and if it is the latter, then the successful IDNO is selected by competitive tender. However, if – contrary to our own view – there is any validity to Ofgem's concern, then we believe that our recommendations for additional licence obligations, restricting access to DNO information, would address it by preventing the DNO from passing over connection applications to its affiliate IDNO – i.e. the affiliate IDNO would only receive such information from the developer (at the same time as its competitor IDNOs).

(D) Ofgem's concern that "affiliated IDNOs may be less effective than non-affiliates at placing competitive pressure on DNOs in such areas as levels of service" needs further explanation. If it relates to standards in respect of non-contestable connection services, then these can be easily addressed by including affiliate IDNOs within the existing competition-in-connections reporting arrangements.

We share Ofgem's view that refusing to grant a licence may not be achievable where the applicant meets its standard application criteria.

### **Conclusions**

Ofgem's concern with regard to incentives on IDNOs is logically common to all IDNOs. Accordingly, imposing specific price control arrangements on affiliate IDNOs would create no benefits for existing DNO customers and would merely reduce the number of competitors available to the developer. It is hard, therefore, to see how such an approach would be consistent with the Authority's statutory duty to protect consumers' interests, wherever appropriate by promoting competition. On this basis, we believe that Ofgem must conclude that its first option is correct and must therefore decide to "treat DNO affiliates in the same way as other potential IDNOs".

We agree that DNO licences should be strengthened to extend the ring fencing/non-discrimination provisions currently applicable to energy suppliers and gas shippers to distribution. This would effectively address Ofgem's concern that a DNO can simply divert lower cost network extensions to an affiliate IDNO.

Yours sincerely

**Denis Linford**

Director of Regulation