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Office of Gas and Electricity Markets
9 Millbank
London
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Dear Sirs,

Regulation of independent electricity distributors: applications from affiliates of existing licensees

I am providing a response to your letter dated April 13th 2006. I thank you for affording me an extension of 1 week to submit a reply.

The background against which my comments are made is one that promotes competition, allows free and easy market access and provides a benefit to customers that become available through choice of suppliers.

We have experience of operating within most DNO areas and can state that the EdF footprint area is one of the less embracing areas for competition in IDNO and ICP activity. Here is not the platform to enter into detail but we would strongly advise Ofgem to consider the Connection Industry Review for 2004 published on November 17th 2005. The most striking fact contained in the report is that EdF across the three licence areas did not issue a single design approval, and in total processed only 49 point of connection applications. Of the 36 in the complex category, none were returned within the expected voluntary standard of 20 days. This is clearly a distribution service area not receptive to or encouraging a competitive environment.

Putting to one side that the application referred to in paragraph 1 of your letter involves EdF, it is not obviously apparent how an application from a Distribution Network Operator by an affiliate company for provision of distribution services within the same distribution service area as the DNO, provides any improved benefit to customers that they would not receive from the DNO.

Neither is it obvious whether developers and other parties procuring connections will benefit from improvements in customer service and gain access to a more competitive market with an affiliate IDNO "competing" against its parent DNO.

Affiliate IDNOs, which I'll refer to as ADNO to avoid confusion, could secure benefit from the DNO when operating in the DNO area that the IDNO cannot enjoy. ADNO operating against the DNO do not provide choice for the developers or large users and could even stifle competition rather than introduce it.

The term affiliated independent DNO contradicts – independent by definition means not affiliated and therefore not afforded the protection of an DNO unlike that of a prospective ADNO.

The framework under which IDNO operate has been developed against a background where DNOs are already licensed. The Utilities Act provided the enabling primary legislation that came into force October 2001. Only over the last 2 years since the change in primary legislation have 3 companies secured licences and a further two have applied.

Each of these will have developed business models and set in place procedures to operate under an IDNO regime.

Consultation took place very recently and concluded in July 2005 – less than 12 months ago that set in place the framework. IDNO are subject to different price controls than DNO, different financing arrangements and will have arrangements geared to that.

There is no real evidence yet available on the benefit of IDNO but to introduce an ADNO not operating under similar arrangements is unlikely to generate improved competition in DNO areas that have yet to see competition develop in either the ICP or the IDNO market and how this ultimately impacts on customers in that DNO area.

The argument over the benefit or otherwise of lower cost network extensions cannot be made this early, this feeds into the hands of DNO not considering ADNO and wishing to prevent IDNO operating in their areas. This argument theoretically extends to say that existing customers will not benefit from IDNO but would from an ADNO who are now apparently incentivised to take on work. This debate needs to be considered outside of this consultation once there is a critical mass of customers under IDNO. It is up to the DNO to argue, build a case and demonstrate they are faced with higher cost elements to deliver the same benefits to existing customers as to those on lower cost network extensions. DNOs continue to take any advantage of lower cost networks due to their dominant position.

IDNO and ICPs have not been able to engage in a competitive market place with DNO assistance. The last Competition in Connection Review shows this with low levels experienced in most DNO areas. The DNO have simply not opened their monopoly market place and there is no evidence to suggest that an ADNO would be any different.

Within section 10 of the October 2005 decision document on SP Manweb commitments under section 31A(2) of the CA a number of concerns were raised and addressed by Ofgem that do not apply to other DNOs but are relevant to competition developing. These commitments were made by a DNO that showed through the CIR to have arguably the most competitive market in connections.

Affiliated ICP still maintain a dominant share of connection activity in area with few operating out of area. How would an ADNO create a market that affiliated ICPs continue to dominate or would a DNO see ADNO as a means for migrating all its connection business under an ADNO, building low cost networks and the benefits associated with them and then argue that they are saddled with higher cost elements of the network to develop and manage? DNO need an incentive to open the connection market that will attract IDNO who would be expected to be more efficient than an ADNO.

Ofgem proposed four options for comment upon;

- How would the ADNO be treated in the same way as other IDNO without a change in licensing arrangements or the introduction of a third price control regime.

- The ability of DNO to operate outside their distribution service area already exists although an ADNO set up specifically for out of area operation has some merit.
- What additional protection is thought necessary for consumers that could not be provided for by the DNO without the need for an ADNO? The existing arrangements should provide adequate protection otherwise Ofgem have failed in their duty.
- Modifying the DNO licence will benefit customers if this makes the market more accessible to IDNO and ICP. Any licence modifications should be on the host with the ADNO operating as any other IDNO.

Existing IDNO were awarded licences and were required to operate in line with the decision document 176/05 July 2005. Regulation should provide a stable regime, promoting medium to long term returns not one of continuing change where short term gain is encouraged. The possible changes in annex 2 impact on existing IDNO now they provide distribution services and therefore on existing customers. Companies have financial arrangements in place and expect a return on an investment. Ofgem will need to look critically how an ADNO is likely to break down a dominant market when they are part of that dominance.

It is our summary view that;

- IDNO must not have their operating arrangements compromised by a change of rules so early in their development
- ADNO granted licences for out of area could stimulate a market.
- It would be detrimental to competition developing (and subsequently to customers) if ADNO were granted a licence to provide distribution services within the parent DNO area while no competition currently exists.
- DNOs should be allowed to compete in any market but changes to DNO licence and separation of asset building and asset owning activities must be made otherwise dominance remains and is even reinforced.
- The commitments undertaken by SP Manweb should somehow be introduced to all DNOs and not be time bound either.

Ofgem comment that refusing to grant a licence may not be an option. If the granting of a licence shows no benefit to customers then refusing to grant a licence fulfils Ofgem primary objectives and Ofgem must not shirk from that responsibility otherwise competition in EdF area may never develop.

Yours sincerely,

D Clare and V.Colby
Directors
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