



John Costyn
Head of Environmental Policy
Ofgem
9 Millbank
London SW1P 3GE

98 Aketon Road
Castleford
West Yorkshire
WF10 5DS

telephone: 01977 605164
mobile:
email:

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Dear Mr Costyn

Ofgem Sustainable Development Report 2006

Thank you for the opportunity to comment on Ofgem's 2006 Sustainable Development Report. I am replying on behalf on CE Electric UK Funding Company and its two licensees, Northern Electric Distribution Ltd and Yorkshire Electricity Distribution plc.

This report is a welcome and timely contribution to the debate on energy policy and sustainable development. To the extent that sustainable development cannot be delivered by competitive markets, policy instruments will be needed. Those policy instruments must create clear long term signals to encourage the necessary investment. It is important therefore for those operating in the energy marketplace to be aware of the principles that would guide Ofgem and the specific initiatives that Ofgem would intend to deploy in order to achieve its aims.

We would therefore support the statement in Sir John Mogg's introduction that an important role for Ofgem and Government is to "remove the barriers to innovation and to provide regulatory and policy frameworks that support long term investment."

As a distribution-only business we do not have comments on every theme listed in the report. However, this response is best structured in relation to the themes of the report.

Managing the transition to a low carbon economy

CE Electric's comments under this theme relate to the promotion of distributed and micro-generation. We have been working for a number of years with Ofgem and the DTI to seek ways to assist the development of more localised means of power generation. We support the current framework of incentives to DNOs to connect DG and the incentives to explore more innovative approaches to network management. It is however the case that the development both of DG itself and of registered power zones (RPZs) has been slower than expected. We have contributed to the DTI's review of the barriers to DG, and we summarise below some of the arguments we have made to the Distributed Generation Review Team.

CE ELECTRIC UK FUNDING COMPANY

Although there is a widely held view amongst DG developers that connection costs, and particularly their timing, are a barrier to development, we would dispute this. Competition in connections is well established and Ofgem has established a set of rules for charging that balances the interests of new and existing customers in terms of balancing upfront and ongoing cost recovery. This is supported by our experience that two thirds of firm quotations for new connections by developers are accepted. Changing the balance of charging further away from upfront cost recovery would need to take into account both impact and risk on DNOs' cash flow. From our own discussions with developers, the main constraints appear to be the level of the energy resource available, planning issues and better opportunities elsewhere, perhaps abroad. If the major hindrance proves to be the economics of the projects, the answer is not to skew connection charges in developers' favour but to seek to address the issue through general support, for instance in the Renewable Obligation.

We support the Innovation Funding Initiative (IFI) and the RPZs initiative and recommend that these be extended to the next price control period. The slow take up of RPZs is not, in our view, due to flaws in the framework but to finding a project which has all the necessary characteristics to benefit from being an RPZ. Others are finding the same problem.

Private networks are often argued as the way forward for community-based DG. In our view, this arises from trading reasons rather than issues implicit in network operation. Installing a private network certainly avoids the need for all generators connected to the network facing BSC membership costs and imbalance costs, but loses customers the benefit of protection through the Interruptions Incentive Scheme and Guaranteed Standards of Performance. We have suggested, as an alternative, setting up "co-generation zones" as part of the DNO's network. In such a zone all normal safeguards would apply other than access to the competitive market (since customers attached to a private network do not have access to the competitive market, this would not be any worse for them). Distributors' obligations under the BSC would be suspended in these zones, and customers would benefit by access to the lower prices available from the co-generation project thus facilitated. We believe this approach merits further examination.

Eradicating fuel poverty and protecting vulnerable customers

We agree that this is an important theme and a key component of an overall sustainability programme. It has often been remarked that much of the rest of the sustainability agenda requires the provision of incentives that involve increasing prices. Ensuring that the interests of vulnerable customers are met becomes increasingly important in such circumstances. Whilst distribution businesses are not the primary agents in addressing these issues, there may well be a number of ways in which we can contribute to solutions, for instance in relation to discussions on prepayment and smart metering and our role in implementing suppliers' decisions on disconnection. We stand ready to help wherever we can.

Promoting energy saving

As the report makes clear, losses from the electricity network represent both a financial and environmental cost. In order to minimise this cost, the correct economic signals, including locational incentives, need to be provided both for operation of the network and for new investment. We therefore support the approach adopted by Ofgem in providing incentives to reduce losses, both of power and of reactive power, from the distribution system.

Ensuring a secure and reliable gas and electricity supply

Maintaining a secure and reliable electricity supply is at the heart of our business. This is dependent on effective investment in the network coupled with the ability to deploy a skilled and adequate workforce to restore supply, maintain the system and deliver new investment

projects. As a regulated business, we rely on our regulatory settlement with Ofgem to ensure that sufficient resources are in place to enable an efficient company to provide this. The last distribution price review recognised this in the increased provision for capital expenditure across DNOs as a whole. As preparations for the next distribution price review get under way, we would ask Ofgem to continue to adopt this approach and avoid an undue emphasis on short term cost reductions which are long term unsustainable.

So far as vulnerable customers are concerned, Ofgem's Discretionary Reward scheme is a novel and helpful way of encouraging DNOs to share best practice about, inter alia, assisting vulnerable customers at times of power interruption. CE Electric is an active participant in this scheme and its work with parish councils to assist vulnerable customers, particularly in providing a dedicated telephone line at such times was commended in the 2006 scheme. We are pleased to see that feedback from the 2006 scheme has been taken into account in the approach adopted for 2007. We would support the continuation of the scheme into future years, taking into account experience gained in previous years.

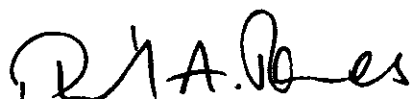
Supporting improvement in all aspects of the environment

CE Electric welcomes the allowance made in the current distribution price review for undergrounding of distribution networks in AONBs and national parks. This has proved very popular with relevant stakeholders. Progress has been slow because of the need to consult and obtain agreement from a wide range of stakeholders, but a total of 85 proposed schemes have been received by CE Electric, of which 22 have reached the detailed design phase and 2, one in each licensed area, have already been completed at a cost of some £350,000. The initiative is popular and we would like to see it continue but there are clearly lessons to be learned from how the initiative has operated so far, for instance in relation to the involvement of BT and public lighting authorities, and it will be important to take this into account.

CE Electric has, through the involvement of the Energy Networks Association, been keeping closely in touch with discussions with Government and wider stakeholders on the implications of possible health effects from electric and magnetic fields from power lines. Ofgem's involvement in these discussions has helped understanding of the issues involved. Ofgem's continuing involvement as the stakeholder group considers possible recommendations to Government will be important to give credibility to the outcome.

CE Electric UK shares Ofgem's views on the importance of a sustainable energy system and the need for a clear strategy to deliver such a system. We welcome the publication of this report and our comments above demonstrate our commitment to work with Ofgem and the Government to deliver on the strategies outlined in it. Issues of sustainability are likely to be increasingly of importance in the future. We look forward to continuing dialogue with Ofgem on this subject.

Yours sincerely,



PHIL JONES
President & Chief Operating Officer