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Dear Martin

Consultation on use of system charges to new electricity distribution licensees: WPD and SP proposals

energywatch welcomes the opportunity to respond to the issues raised in this consultation letter. This response is non-confidential and we are happy for it to be published on the Ofgem website.

We have already responded on behalf of consumers to the specific changes on distribution use of system (DUoS) charging to apply to independent distribution network operators (IDNOs), most recently to SP's proposed approach. We noted in response to the second SP consultation our concerns that charges imposed on IDNOs will be much higher if SP adopts more cost reflectivity.

We recognise that cost reflectivity is a relevant licence objective that SP and WPD must consider when developing their DUoS charging methodologies. However, there must be a balanced approach which also takes into account other licence objectives, specifically relating to facilitating, and not restricting, distorting or preventing, competition. DUoS charging must also reflect a balance between cost reflectivity and ensuring that charges are transparent, simple and stable. The vast majority of connected users and consumers are passive recipients of distribution services. They are highly unlikely to respond to signals provided by more cost reflective charging and are essentially captive customers.

Taking the example of the IDNO networks, regardless of the extent to which networks may become embedded, the suggestion that more cost reflective DUoS charging will be a key determinant of the IDNO's connection to a larger IDNO's, or to a host DNO's, network is tenuous. A number of different factors will determine location, including local planning issues, the attractiveness of an area for development (in the case of new house builds) which may drive the IDNO's initial investment, and even whether there is nearby commercial development which would provide local services to end consumers connected to the IDNO network. If DUoS charging does become a bigger factor, there would be a potential risk that increased cost reflectivity encourages IDNOs to cherry pick where they connect or fail to develop. The existence of the price cap on recovery of DUoS charges may force some IDNOs to connect at certain points on the network to maximise revenues. This

approach could impact on the competitiveness of connections across the host DNO's network. If IDNO margins are cut, it will also provide the host DNO with a competitive advantage over IDNOs which would restrict or distort competition under the terms of the licence objective. Consumers require more, not less, competitive connections.

We accept that much IDNO activity may be linked to new house building, and that using a domestic load profile seems more sensible in setting the IDNO's DUoS contribution compared to use of a commercial or non-domestic profile. We also consider that the use of boundary metering at connection points would assist the host DNO to better plan its network by more accurately recording usage and ensuring that better quality data enters the settlement process. However, these positive aspects of the proposals are also based on assumptions about load profiling. Cost reflective charging should be based on firmer evidence. It may be preferable if WPD and SP undertake the necessary load research, postponing the implementation of their proposals on IDNO charging until a package of changes emerges from their separate reviews of the long-term structure of DUoS charging on their networks. This would ensure a more consistent and rounded implementation approach.

While we note that both WPD and SP expect to obtain savings by avoiding costs through a more cost reflective approach to charging IDNOs, there is no clear statement that these savings would be passed through to end consumers. It would make the proposed changes more palatable to consumers if the savings to be made are passed back to consumers in a transparent fashion or used to improve the service provided by DNOs to consumers.

Going forward, we will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs