

Martin Crouch
Director, Electricity Distribution
Office of Gas and Electricity Markets,
9 Millbank,
London, SW1P 3GE

8th May 2007

Dear Mr Crouch,

Ref: Structure of electricity distribution charges: update on progress and next steps

Thank you for the opportunity to comment on current developments in electricity distribution charging as set out in your open letter of 3rd April 2007. Laing O'Rourke Energy (LOE) is a first generation independent distribution network operator (IDNO) with three operating networks. As such we have real experience from dealing in the competitive market for electricity distribution services and new connections. We are not encouraged by this experience and believe competition from electricity IDNOs is in danger of withering before it even starts.

We are extremely concerned at the state of competition in electricity distribution as I mentioned to you during our brief discussion at the first distribution charging methodologies forum last Thursday. The market, such as it is, is structured against competition to the incumbents both in the way distribution network operators (DNOs) deal with us on a day-to-day level and particularly in the way that their charges are structured. The charging structure results in many cases in a negative margin for the IDNO, particularly in the period leading up to full occupation. This is in stark contrast to the markets for other utilities services like telecoms and gas, where service standards are generally higher and/or there is real competition for incumbents.

Without major changes to the way the electricity distribution market operates, competition will remain elusive even after all the efforts of recent years and the recent encouraging proposals from the Competition in Connections review. We have significant concerns at the rate that competition has developed in electricity distribution, at <5% of the market place. This compares with gas connections where nearly 50% has been achieved over a comparable time frame based on the 2005/06 CIR. To achieve the 5% in electricity connections figure Ofgem has to date relied very much on the industry incumbents and the establishment of numerous working groups to develop mechanisms to facilitate competition. This has obviously not proved effective based upon the current level of electricity connections being delivered through competition. I fear that continuing to rely solely on this route of industry forums, such as the DCMF process is likely to result in slow minimal effective progress. It is our experience these forums tend to be guided by the incumbent DNOs existing views and policies, the consequences of which mean that

progress to a more effective regime is stalled whilst proposals are debated internally amongst peers and management.

Long term charging methodologies

We believe this process needs much more engagement and control from Ofgem, which continues to push very hard for early implementation. The various DNOs are developing a number of different methodologies which are complex to follow and only result in indicative charges being released very late in the process. Only when the indicative charges are available can we assess the possible implications of change.

HV/LV generator charging and charges for existing generators

We understand the need to develop charging structures in this area and are supportive of industry efforts.

Charging products and structures

Any development work in this area should be well trialled and implemented with care. They should also account specifically for IDNOs as we do not feel it is acceptable for sudden changes to pricing to be regarded as normal commercial risk for us operating long life assets. We believe provision should be made for IDNOs to opt out of any such arrangements where we feel they may cause us significant commercial damage.

Methodology statements

We are in favour of consistent methodology and use of system charge statements across all DNOs. We also believe they should present connection offers in a consistent way highlighting contestable and non-contestable elements, as we have commented separately in the recent competition in connections consultation.

Charges to IDNOs

We support the development of specific distributor to distributor charges in principle providing that they rebalance the cost structures we must pay to align with the charges we can levy on consumers connecting to our wires. We believe IDNO charges need to be set in a non-discriminatory way by DNOs that allow the IDNO to make a comparable margin to that of the DNO for operating and maintaining the same part of the network and maintaining it's obligations under the licence to the consumer.

As I mentioned to you last Thursday, our analysis suggests that in many instances a DNO can be better off by an IDNO connecting to its system because it is able to levy more on the IDNO than they would receive if they were connected direct to the consumers, with a much reduced exposure to risk. This is particularly the case in the main UK growth area for connections, the domestic residential market. This will have the effect of excluding these customers from competition due to the negative DUoS margins, which obviously is not beneficial for the consumer or the development of the industry.

the POWER to Connect



We believe Ofgem must take a much more assertive approach to ensuring that competition in electricity distribution actually happens. I am keen to meet with you more formally so I can share with you my concerns and provide you with evidence to demonstrate how the current charging framework specifically impacts on LOE. Perhaps your office could contact me to arrange a convenient time for this.

Yours sincerely

A handwritten signature in black ink, appearing to read "D Grundy". The signature is fluid and cursive, with a large loop at the beginning and a long, sweeping tail.

Darren Grundy

Business Leader

For Laing O'Rourke Energy Ltd

Laing O'Rourke Energy Limited

Barford Road, Little Barford, St Neots, Cambridgeshire PE19 6WB

tel: +44 (0)1480 402640 **fax:** +44 (0)1480 402572 **web:** www.laingorourkeenergy.com

Registered Office: Bridge Place, Anchor Boulevard, Admirals Park, Crossways, Dartford, Kent DA2 6SN. Registration Number: 4718806. Registered in England.