

27th September 2007

Martin Crouch
Director, Distribution
Ofgem
9 Millbank
London
SW1P 3GE

Dear Martin,

**Ref: Revised proposals for IDNO charges from WPD – modification proposal
WPD/WALES/WEST/UOS005**

We have reviewed the above document of which we were notified by Western Power Distribution (WPD) on 14 September. We responded to Ofgem's consultation on this earlier proposal—and Scottish Power's similar initiative—in June expressing a number of very serious concerns about the way WPD was approaching this very important issue.

We continue to believe that introducing distinct charges for IDNOs should be a priority for all DNOs and Ofgem should continue to pressure for this. However, as we said in our June letter: *"We think there is a danger that regulatory oversight will stop at the theoretical leaving the DNOs a free hand to implement any new arrangements as they see fit and to their own commercial advantage. We do not believe engaging in a consultation process which is impossible for key stakeholders to assess, results in significantly different charges which do not seem to be cost reflective and which will surely hinder competition can be consistent with the DNOs' applicable objectives."* We continue to have very serious concerns about this proposal: we believe it will do little or nothing to encourage competition in distribution in the WPD area and is merely a device by the incumbent to protect its competitive position.

Main impacts of the revised proposals

We have reviewed the revised proposals and wish to highlight the following points:

1. margin squeeze—they are likely to leave IDNOs less room to earn a margin than the current charging practice of applying use of system charges as if the IDNO were a single load;
2. use of distance—the arbitrary selection of distance-related criteria need to be challenged as they are being used to steer IDNO activity to areas near existing substations (which are presumably the most developed in a DNO's territory) and away from making connections further away;
3. the proposals still address predominantly domestic developments and make no real attempt to address mixed use where we have built and operate networks in

other areas. The introduction of discretion in the allocation of tariffs about the 50% domestic use threshold is a minor improvement in this context; and

4. WPD's comments on its further consideration of changes to its customer service and billing costs of customers as a result of IDNO activity, in section 2.18 of its modified Amendment Proposal should be challenged. WPD are saying that these costs are not likely to reduce as IDNO activity is not likely to be significant enough for it to downgrade its resourcing and thus costs. Therefore, it says, no allowance should be made. IDNOs will, however, incur all of the costs identified by WPD in this section, at a proportionately higher level than the DNOs due to economies of scale. WPD are effectively saying that unless competition reduces their operating costs they will continue to charge IDNOs for services which they do not provide to them. This is patently anti-competitive.

Use of distance

The proposed bands are from 0% to 25%, 25% to 50%, 50% to 75% and more than 75% of the average WPD LV circuit length to connect the IDNO to the substation. The WPD document quotes average LV circuit lengths in WPD South Wales as 228m and WPD South West as 256m. Thus the bands emerge as shown in the Table below.

Estimated distance from substation for application of WPD IDNO tariff bands

	WPD South West	WPD South Wales
Average circuit length (metres)	228	257
Band 1 0-25%	Up to 57m	Up to 64.25m
Band 2 25-50%	57m to 114m	64.25m to 128.5m
Band 3 50-75%	114m to 171m	128.5m to 192.75m
Band 4 >75%	Over 171m	Over 192.75m

This structure will focus IDNO activity to areas close to existing substations which will be well developed and thus of limited opportunity. The DNO seems to have designed this structure to give itself a huge competitive advantage in the Greenfield sector, where we expect most development to take place.

I hope these comments are helpful. Should you require any further comment or clarification please do not hesitate to make contact.

Yours sincerely,

Darren Grundy
Business Leader
For Laing O'Rourke Energy Ltd