

9 May 2008

Rachel Fletcher
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Office of Gas and Electricity Markets
9, Millbank
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Dear Rachel

Delivering the electricity distribution structure of charges project

I am responding to the recent Ofgem consultation on the above subject on behalf of all ENA electricity Distribution Network Operators (DNOs) with the exception of WPD and SP. The companies will also be submitting their own detailed response to the consultation, but felt it worthwhile to highlight in a joint letter the strength of their concerns with the current proposals.

It is disappointing Ofgem considers that the DNOs have failed to meet deadlines under the structure of charges project. All of our members are committed to ensuring their charging methodologies are fit for purpose and meet their licence obligations. Whilst it is true that the structure of charges project has encountered delays, these are due in no small part to Ofgem seeking a particular methodology that has a poor fit with the charging principles¹ that such a methodology is designed to achieve.

For example, it is not possible to produce a totally cost reflective charging methodology based only upon a forward looking incremental cost model alongside the requirement that such a model accurately reflects network costs incurred, and is predictable and transparent. Whilst cost reflectivity is, quite correctly, an important consideration for any charging methodology, in practice it must be balanced against the needs for simplicity, predictability and transparency.

All DNOs are committed to ensuring their charging methodologies comply with standard licence condition (SLC) 4. Part of this condition requires that compliance with any use of system charging methodology facilitates competition in the generation and supply of electricity and does not prevent or distort competition in the transmission or distribution of electricity. SLC4 also requires DNOs not to discriminate between customers or class of customers and to take account of developments in their distribution business.

¹ Established by the Ofgem led Implementation Steering Group and noted in section 3.13 Consultation on the longer term framework 135/05 – May 2005.
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=187&refer=NETWORKS/ELECDIST/POLICY/DISTCHRG>

As such, and as a continuing part of the structure of charges project, all DNOs are seeking to bring forward revised charging methodologies that strike a balance across the agreed high level principles of cost reflectivity, simplicity, transparency and predictability as well as facilitating competition. All DNOs are working towards the earliest possible implementation dates that can be achieved both through the process of establishing robust and enduring methodologies and delivering the models required to implement them.

Whilst it is true that only two DNOs have implemented a revised charging methodology to-date, all other DNOs have made substantial progress in developing their own proposals. Indeed, many have engaged with stakeholders through workshops and formal consultations and have been in constructive discussions with Ofgem on their proposals.

It is our members' very strong view that imposing a licence obligation on DNOs to develop and have in place revised charging methodologies by 1st October 2009 will be counter productive. They feel that it will stifle innovation, result in current work being dismissed (at significant cost) and will fail to deliver what is required.

First, regarding stifling innovation. We would refute the argument that there has been a lack of innovation to date. Currently there are at least three different forward looking charging methodologies either in place or being developed by DNOs or groups of DNOs, each with innovative solutions to the complex requirement to provide some form of forward looking price signals. Furthermore, since April 2005 various DNOs have submitted modification proposals for modifying charges to IDNOs and / or charging for reactive power. We strongly believe that the only way to ensure innovation is to allow DNOs the freedom to develop charging structures around the broad requirements of the current licence obligations.

Secondly, our members believe that mandating the use of a common methodology will result in a significant amount of work-to-date being dismissed. If, as suggested by Ofgem, one methodology is chosen as a 'blueprint' then clearly the majority of work on alternative (and innovative) methodologies will be lost. We do not believe that a common methodology will be able to build on this work or indeed save DNO resources going forward. Furthermore, allowing a variety of methodologies to be implemented will allow understanding of their relative strengths and weaknesses in practice. Over time this will feed further improvement in the overall effectiveness of each methodology, bringing benefits to all customers.


Thirdly, and most importantly, we do not believe that imposing a licence obligation on DNOs will achieve what Ofgem (and industry) desire. With regard to Option 1 outlined in the consultation paper: as noted above, all DNOs either have or are in the process of developing new charging methodologies based upon the high level principles. Any obligation to develop a charging methodology to a more detailed and prescriptive set of principles would be counterproductive; it would add cost and stifle innovation. With regard to Option 2: in addition to the concerns over Option 1, we do not believe that it is possible to develop the common charging methodology prescribed by Ofgem that adheres to the relevant principles outlined in Appendix 4. Any charging methodology will always have to achieve a balance between a set of agreed high level principles; it will not be able to conform to detailed and prescriptive principles as outlined by Ofgem. Indeed, as noted above, this has been part of the problem to date in bringing forward charging methodologies that meet all of Ofgem's preferences.

Imposition of a common charging methodology would only be achievable if Ofgem takes ownership of (and ongoing responsibility for) it. We do not believe this is in the best interest of industry or the market.

In summary, the ENA members above are extremely concerned with Ofgem's proposal to impose a licence obligation to bring forward new charging methodologies by 1st October 2009 when all have either implemented or have work well under way to implement their own, innovative solutions. These members are particularly concerned that Option 2, Ofgem's preferred approach, is both impractical and unachievable. Instead, they believe that the focus should be on bringing forward the various methodologies currently under

development so that Ofgem can assess whether they better meet the relevant objectives of SLC4.

Yours sincerely

A handwritten signature in black ink that reads "Andy". The signature is written in a cursive style and is underlined with a single horizontal stroke.

Andy Phelps
Director of Policy and Regulation