

Lewis Hodgart
Ofgem
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19th August 2008

Dear Lewis,

Delivering the electricity distribution structure of charges project: decision on a common methodology for use of system charges from April 2010, consultation on the methodology to be applied across DNOs and consultation on governance arrangements

Whether respondents agree that we should specify the common methodology to be applied across DNOs

Yes, we agree a single common charging methodology across all DNOs is preferable. Whilst we appreciate the merits of cost-reflectivity, our main concerns are predictability and stability over the next 4 years. We believe Ofgem would be best placed to make a balanced assessment of the competing methodologies on behalf of a range of stakeholders.

Suppliers who have a broadly representative mix of DNO customers in terms of domestic, I&C and SME take advantage of the revenue stability of the price control. Niche players do not have this and are thus exposed to disproportionate and unhedgeable risks in terms of the variability of Network Operator charges.

Pros, cons and impacts of each model

We would like to make more general points:

- A key requirement of the charging arrangements is to support competition in supply and generation. In practice, this is likely to mean that simpler and transparent arrangements are probably better than over-complex modelling which is difficult to predict and understand.
- In the event of changes that we have not been able to reasonably predict, we either have to take the financial hit or pass through to our customers. Passing costs to customer through re-pricing in our experience can be very damaging to a supplier reputation as not all suppliers are affected to the same extent depending on their portfolio mix. We therefore value stability and predictability.
- We also believe that customers would prefer a world of stability and predictability. Most businesses make budgetary allocations for unforeseen costs but do not make allocations for windfall gains. Therefore they are unlikely to be able to maximise the value of their own working capital during the year. The recent move to allow charges to be set twice a year in part recognised this.
- We favour some sort of year-on-year capping mechanism to further support stability. We would like to suggest that the rate of change of any costs attributed to a single customer should be limited to say 5% per annum.

Governance arrangements and the options set out in annex 3

An industry code governance arrangement based on the DCUSA model would seem to be appropriate. We are not convinced that it is necessary to do nothing now and consider the option under the wider review of governance codes.

The processed processes set out in annex 4
No comments

Whether there are any other matters we need to consider in light of our decision on a common charging methodology

Consideration should be given to suspending any further methodological changes until the common methodology is agreed. This would avoid unnecessary costs to the DNOs and suppliers in making unnecessary short term changes to their systems and cost bases. Multiple methodological changes over a short notice could also lead to unnecessary and potentially significant cost fluctuations.

Trust that our comments are helpful. This response may be treated as non-confidential and should you wish to discuss further then please do not hesitate to contact me.

Yours sincerely,

Keith Munday
Commercial Director