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Rachel Fletcher
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15 August 2008

Dear Rachel

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

I am responding to the above decision letter on behalf of the DNO members of the Energy Networks Association. The consultation document recognises that most DNOs were opposed to a policy change in favour of a common methodology. It is disappointing that the decision has been taken to pursue this approach at this very late stage in the project, where many DNOs have submitted, or are on the verge of submitting, fully developed proposals. However, DNOs will of course work closely with Ofgem to help deliver a successful outcome by the due date of April 2010.

The DNOs firmly believe that the decision to opt for a common charging methodology requires Ofgem to lead from start to finish so that compliance risk is removed. A critical aspect of the leadership will be for Ofgem to define and designate a common methodology in sufficient detail as to minimise the scope for disagreement (effectively leaving each individual DNO with responsibility for application of the methodology and for the actual pricing calculations). It is also important to recognise that competition law may constrain DNOs from jointly agreeing approaches beyond those specified by Ofgem, and those details missing from, or unclear in, Ofgem's specification may therefore compromise the desired commonality of outcome.

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As well as developing clear project objectives and milestones, Ofgem will also need to chair the relevant project meetings and to promptly determine matters where agreement cannot be reached. Failure by Ofgem to provide this level of leadership may expose the companies to significant regulatory risk outside of their direct control.

Although we do not specifically comment on the pros and cons of the methodologies currently 'on the table' whichever one is chosen will have potential cost implications for the companies, which might vary significantly from company to company. This will be particularly true in relation to billing systems which may need to be modified to accommodate any new charging methodology. Consequently, it will be important for Ofgem to confirm that there will be full recovery of costs incurred to date and during the remainder of the project. This should include the cost of the significant resources that have already been sunk into the development of new methodologies which now face being stranded. The letter mentions that these costs are not significant; but you state that parties have indicated that they amount to £0.5m per DNO which the DNOs believe is a material sum.

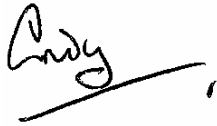
It will also be important to clarify the role within the project of the licensed Independent Network Operators (IDNOs) (as well as other parties such as suppliers and generators). In Annex 4 there is no mention of their involvement yet any DNO common charging methodology will by necessity require a specification of the structure of charges to IDNOs/ third party networks and will affect IDNO charges to their customers. It may also be appropriate for Ofgem to revisit the current IDNO price controls which allow them to cap their charges to domestic customers at the level of the host DNOs charges.

On the question of the future governance of any future common charging methodology, the companies agree that discussion of this issue should take place in parallel with the structure of charges project. They are also of the view that the decision on change proposals should rest with distributors and that we should aim for a simple and relatively inexpensive approach, similar to the Distribution Code governance arrangements. It will be necessary to avoid governance that facilitates the pursuit of narrow vested interests, rather than genuine improvement in the interest of all. One key area that will require clarification will be Ofgem's powers regarding dispute resolution. Disputes can be costly for the parties involved and can be avoided if a process is detailed at the offset.

The timeline outlined in Annex 4 is extremely challenging given that Ofgem is looking to encompass all aspects of charging including IDNO charges and generator charging. These developments will also interact with the current price review process and it will be important that this is acknowledged and built into the process at an early stage.

I hope you find my comments helpful. If you have any questions on any of the points raised do not hesitate to get in touch.

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 & Regulation

CC Lewis Hodgart