

Lewis Hodgart
Ofgem
9 Millbank
London
SW1P 3GE

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Distributionpolicy@ofgem.gov.uk

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Dear Lewis

Delivering the electricity distribution structure of charges project

energywatch welcomes the opportunity to comment on this development. This response is not confidential and we are happy for it to be published on the Ofgem website.

energywatch supports the establishment of a common charging methodology for the distribution network operators (DNOs). There are no grounds for applying different approaches to consumers where the only distinction is that they are connected on opposite sides of a network boundary.

We note the claims made by large suppliers about the benefits that will be seen from this development, but are sceptical that consumers will actually see these benefits, as competition between suppliers is not well developed. We would urge Ofgem to monitor this closely to ensure that suppliers deliver on the claims they are making.

We believe that Ofgem will probably need to specify the common methodology to be applied across DNOs. To date, DNOs appear to be pursuing different approaches and it seems unlikely that they will be able to agree a methodology in a timely manner. However, one of the themes of the DPCR discussions so far has been to encourage DNOs to become more proactive and responsive. We would suggest, therefore, that DNOs are given an opportunity to propose and justify a common methodology. If a suitable proposal is not forthcoming in time, then Ofgem can specify the methodology as it has proposed.

We agree that the development of a use of system charging methodology is a balancing act between a number of competing principles. In making its decision, whether it is specifying the methodology or accepting the DNOs' justification, we urge Ofgem to take account of the facts that the vast majority of consumers are involuntary users of the network and passive recipients of a DNO service with suppliers standing between consumers and the DNOs.

Suppliers will build a risk premium into their prices to consumers to compensate for perceived uncertainty about the future levels of charges from the DNOs. A number of factors can create this uncertainty, for example the potential for volatility over time. Uncertainty will also develop when there is a mismatch between a DNO's charging structure and a supplier's pricing structure; e.g. if the DNO charges on a nodal basis, while the supplier prices for a DSA. The potential for significant step changes in charges from adopting the new methodology is also likely to be used by suppliers to justify a risk premium. As a consequence, we would urge Ofgem to focus on the simplicity, predictability and transparency of charges when assessing which methodology should be adopted. The decision should also support the use of publicly available data that could allow others to replicate the derivation of charges. If adopting the common methodology looks like it will create significant step changes, Ofgem should consider establishing a glide path to mitigate the changes. We support the development of governance arrangements to ensure that commonality is not eroded over time and to enable parties other than DNOs to raise charges proposals. We believe this needs to be conducted as a separate exercise to the industry codes governance review, so that implementation of these changes is not delayed by issues in other parts of the industry. Although separate, these governance discussions should be pursued as a parallel work stream, taking account of developments within the main review.

With regard to the options for governance, we favour building the arrangements into an existing agreement such as DCUSA on the basis that mechanisms are already in place and this should require the least additional resource, a factor that will be particularly important for smaller players and non-industry participants.

If a clash between the objectives of the DCUSA and the common charging methodology prevents the development of this option, we would prefer to see the governance arrangements established through modification of the current DNO licence. In this case, there will need to be a co-ordination mechanism between DNOs. This function could be provided by one of the existing code secretariats. In addition to the licence modifications proposed, we would expect the obligations on DNOs to go further than just consider and formally respond to change proposals from non-DNO industry parties but also to consult with other parties on these proposals. If this additional step is not included, then DNOs would be able to reject any proposal without wider discussion.

We consider that developing a new charging methodology code (option three) will introduce additional complexity and demand more resources than the other two options and so do not support this.

We note that in option two there may need to be an obligation on DNOs to consult with other parties before submitting a formal modification proposal, we would suggest that the licence is modified to this effect whichever option is chosen.

With regard to the licence modifications needed, we agree that there should be new provisions covering the development and implementation of the common methodology, but instead of this condition falling away, we see it having an enduring role to cover the need for the ongoing governance of the methodology. On this

basis, we believe that these changes are better sitting in Part A, though modifying SLC13 and SLC14 as appropriate, so that they apply to all DNOs.

We note the proposed provision for allowing a DNO-specific treatment in certain cases and would suggest that this provision should not only require the DNO to inform Ofgem of any such changes, but also that they provide suitable justification. We would also expect Ofgem to approve the application of the common methodology and any “tweaks” in separate decisions.

Subject to our comments above on the location of the condition in the licence, we consider that the framework for the licence condition on common governance arrangements is appropriate. Building on the comment about clarifying whether DNOs hold a collective or individual position on a potential proposal, we would suggest that this information should be disclosed as a part of all proposals.

We would appreciate being kept informed of progress in this area and of any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 221 2072

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs