Electricity North West Limited
Dalton House
104 Dalton Avenue
Birchwood Park
Birchwood
Warrington
WA3 6YF

Telephone: 01925 534550

Rachel Fletcher
Director Distribution
Ofgem
9 Millbank
London
SW1P 3GE

Direct line 01925 534504

Paul.Bircham@enwltd.co.uk

19th 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 disappointed that you have ignored the views of the distribution businesses in arriving at the decision to oblige the DNOs to apply a common use of system charging methodology determined by Ofgem. This decision restricts the ability of DNOs to define commercial policies which reflect their particular circumstances and reduces the ability of DNOs to innovate; we therefore believe that it is less likely to result in approaches that best reflect the Relevant Objectives for each DNO individually. More importantly, given the work to date that many DNOs may have to abandon, it puts at risk the stated objective of delivering new charging methodologies for the start of the new price control period. However, ENW have always operated a policy of constructive engagement with Ofgem and we will continue to assist and support the Ofgem team in the assessment of alternative methodologies.

Our decision on whether to accept any proposed licence modification must be based on our assessment on whether we are able to implement the common approach within the required timescales. For this reason it is essential that Ofgem now take a clear leadership role in the process, both in the initial specification of a chosen charging methodology and in decision making on any implementation issues that may arise during the course of the project. Another key factor for ENW is the ability to use our Expansion Planning and Pricing (EPP) software. The ability to undertake the required power flow analysis for the methodology is clearly on the critical path of the project. In order to submit proposals by October 2009 then this analysis will need to be substantially complete by April 2009 at the latest. We believe that EPP has sufficient capability and flexibility to accommodate any of the models currently under discussion, however if Ofgem are too restrictive in their definition of how the load flow analysis is undertaken then this may not be the case. In such an event, major development of the load flow analysis package may be required which would be a significant challenge in the required timescales.

Electricity North West Limited
Registered in England & Wales No: 2366949
Registered office: Dalton House, 104 Dalton Avenue, Birchwood Park, Birchwood, Warrington WA3 6YF

Given the considerable, now potentially abortive, expenditure that we have incurred to date on the Structure of Charges project and the additional development and implementation costs that we may now incur, we would expect that Ofgem will develop a process for their reimbursement.

We urge you to make the decision as to the common approach as soon as possible and to publish the description of the common charging methodology with all available detail. Any delay now in making the decision will have a multiplying effect on timing at the end and any uncertainty as to the form of the common approach will cause implementation delays as clarification is sought from Ofgem. We have responded to the questions raised in the decision document and these are included in the attached Appendix 1.

If you have any questions or queries on our response please do not hesitate to contact myself on the above number or Tony McEntee on 01925 534499.

Yours sincerely,

Digitally signed by Paul Bircham
Reason: I am approving this document
Date: 2008.08.19 16:17:36 +01'00'

Paul Bircham
Regulation Director

cc Lewis Hodgart, Ofgem

Appendix 1 – Responses to the questions raised in the decision document

Views Sought

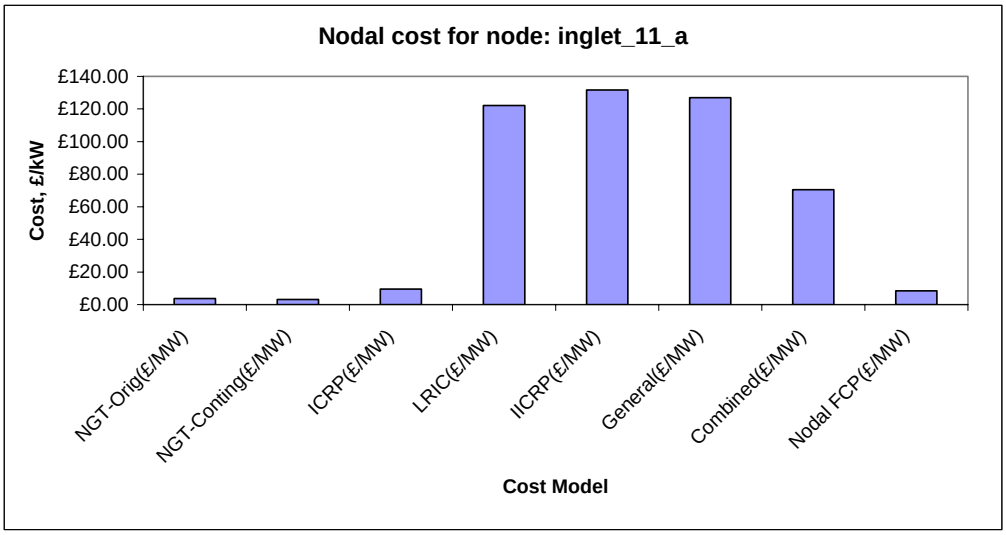
1. **whether respondents agree that we should specify the common methodology to be applied across DNOs;**

   We do not agree with Ofgem's decisions for the reasons set out in the body of this letter and as detailed in our response to the initial consultation.

2. **the pro, cons and impacts of each model;**

   EHV Models

   As communicated previously we have always believed that a hybrid approach to charging is appropriate. The LRIC/ FCP approaches attempt to reflect the impact of load growth on our future costs, whereas we believe that ICRP methods give a better reflection of the costs where load growth is not as significant. Our approach has been to evaluate a number of options by developing appropriate analytical tools and a comprehensive network model. We are currently analysing the results from our total network model and these highlight the concerns we have already raised with your team regarding aspects of the WPD-LRIC approach. This approach can lead to high nodal charges which we do not believe reflect the underlying reinforcement costs. Figure 1 illustrates the difference costs to be recovered from the same node on ENW's distribution network for the eight cost methodologies modelled by EPP.



   We are also concerned that the WPD-LRIC approach requires the use of a global growth rate, independent of likely trends at individual nodes, which can also lead to perverse results. In our development of the DF and EPP software we have recognised this shortcoming and amended the LRIC cost model to enable nodal growth rates to be

applied. The model selected by Ofgem should reflect real expectations of growth in particular areas. We will continue to support your team with the analysis our EPP software can now provide.

Our analysis to date indicates that the LRIC approaches are over-sensitive to assumptions, particularly the growth rate, and produce charges which do not reflect the underlying reinforcement costs. We believe that the adoption of such an approach will cause major implementation problems with customers which will jeopardise the completion of the project in the required timescales.

HV/LV demand

In many respects the DRM and Cost Allocation using RRP are very similar. Both approaches should source inputs from defined data sources. We do believe that networks costs are better determined from a network model rather than using expenditure trends from the RRP because the costs derived from a network model will deliver a stable, long run view. Our concern with using expenditure trends from RRP is that costs year on year fluctuate as companies prioritise over time their spending across their distribution networks, with differing spends between asset types and network levels each year.

HV/LV generation

We believe that this can be accommodated within the DRM and we support this approach as it provides the most consistency between the calculation of demand and generation charges.

Revenue Reconciliation

We believe that a fixed adder approach can be used in conjunction with the DRM. The output of the detailed EHV analysis is not likely to match exactly the calculated EHV DRM costs and an initial fixed adder should be used on EHV charges in order to align them with the DRM before the overall fixed adder is applied.

Tariff Structures

Our tariffs are the most expansive of any of the DNOs and we would be concerned if commonality was limited to the capabilities of a single DNO. Moving to the lowest common denominator would reduce economic signals to network users, limiting our ability to encourage efficient network development and use. Any proposal of common tariff structures should be based on requirements in the medium/ long term and there should be recognition that it may take time for all DNOs to achieve this.

3. governance arrangements and the options set out in Annex3;

Whilst we disagree with the decision on a common methodology, it would render this decision pointless if the common approach was then eroded over time. Our views on the governance approach have not been finalised. We can see merit in some form of code

approach as it could bind all stakeholders into the process; however this is tempered by experience of codes modification processes which can become an industry in their own right. The approach for the gas distribution methodologies being incorporated in licences may be more appropriate. Due to the timescales involved in the initial implementation, and the licence obligations proposed for DNOs, stakeholder involvement during this stage will have to be greatly restricted.

4. **the proposed processes set out in Annex 4;**

   There requires more formal involvement by Ofgem. It will also be important to clarify the role within the project of the licensed Independent Distribution 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. Whilst industry participation in the working groups is welcomed they cannot be included in the decision making process due to the delivery obligations that are being placed on DNOs. The timescales are very tight and we have now already stopped work on aspects of the Structure of Charges work in light of this decision.

5. **whether there are any other matters Ofgem need to consider in light of their decision on a common charging methodology.**

   In terms of the Licence drafting, SLC13 would need to be revised in respect of the Relevant Objectives as it will be for Ofgem to determine that its chosen methodology satisfies the criteria it specifies, including competition law. Licensees' responsibilities will now be limited to appropriately implementing Ofgem's decreed methodology. ENW expect to see in Ofgem's description of a common methodology further detail on those aspects linked with the application of a common methodology. We expect Ofgem to describe how the connection boundary is defined within a common use of system methodology; how asset adoption payments form part of the common charging methodology; how capacity and reactive charges should be applied.