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11 August 2008



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Dear Nicholas,

**Consultation and impact assessment on EDF Energy Networks
proposal UoS Mod 21**

Thank you for the opportunity to provide views on this important consultation about the future structure of distribution use of system charges levied by EDF Energy Networks.

ESP Electricity (ESP) owns and operates three IDNO networks embedded in the wires operated by EDF Energy, although not in the South Eastern (SPN) network. Our understanding is that the company intends to apply a similar methodology in its Eastern and London networks, should this proposal be approved for its SPN network.

This response addresses three areas:

- our views on objectives that should apply to distribution use of system charging reform;
- specific comments on the EDF Energy proposals as consulted on by Ofgem; and
- a concluding comment on Ofgem's separate proposal to permit EDF Energy to operate IDNO networks embedded in its wider DNO system, to which we object very strongly.

The response builds on our letter of 19 February replying to EDF Energy's second consultation on this issue, particularly as we believe none of the concerns we raised then has been addressed.

Objectives of distribution use of system charging reform

As the operator of a small number of IDNO systems with the aspiration to increase our presence in the electricity sector, we consider it essential that DNO use of system charges are subject neither to unexpected shocks nor margin squeeze. Both these factors can impinge on the viability of our investments. Our starting position for the longer-term charging development work currently being undertaken by all the DNOs is to seek to minimise charge disturbance for our existing customers subject to the maintenance of commercial and operational viability of our investments.

We welcome and support Ofgem's current proposal for a common charging methodology for implementation from April 2010. An appropriately designed common charging approach will be much more manageable for smaller participants, especially IDNOs.

We believe that the EDF Energy proposals absolutely fail to address what we think are very sensible long-term priorities and, moreover, are very likely to increase the level of risk we face in managing our IDNO investments. Because they also fail to address IDNO charging at a time when EDF Energy is seeking to be an IDNO, we do not believe they should be implemented.

Specific comments on the EDF Energy proposals

We have a number of specific concerns about the EDF Energy proposals:

- lack of IDNO charges. Naturally this is our primary concern. Presently our investments in the EDF Energy network operate at very low margins. However, whilst the host DNO imposes additional capacity-based charges on us, our charges to end users are the same as if these customers were connected to the EDF Energy network. This situation underlines IDNO vulnerability to charge changes levied by the host DNO to its mainstream customers, and this matter requires specific consideration within the joint DNO development work. This situation must be addressed as a matter of priority. We are extremely disappointed that EDF Energy has yet to propose IDNO charges and must conclude that it is not according this issue the priority it deserves. In the present circumstances, however, we would strongly prefer any further efforts in this area to be directed through the common methodology work-stream.
- margin squeeze. Our evaluation of the proposed EDF Energy SPN charges set out in the Ofgem document with the rates currently in force suggests there might be a widening in the differential between domestic and monthly-billed charges under the proposed rates. The implication from this is—in the absence of IDNO charges—that margin squeeze based on existing structures should reduce in the SPN area were the new charges to be implemented. This would be a helpful development and, although we also note EDF Energy's analysis which suggests that margin squeeze is not a feature for the two IDNO networks currently in the SPN area, we believe it has arisen more by accident than design. Consequently this situation could be reversed at some point that we cannot predict in the future. It also underlines how important it is for a credible and enduring IDNO charging regime to be developed as part of the new long-term charging methodology.
- charging volatility. As with the EDF Energy distribution businesses, as a company ESP is making long-term commitments by investing in electricity distribution assets. EDF Energy has the confidence that the combination of regulatory price controls and charging methodologies, which it controls, will enable it to earn a long-term return on those investments. Without dedicated charges, IDNOs cannot have the same confidence and this factor will significantly restrict the benefits to customers of competition in distribution.
- time of use charging structure. We are concerned that EDF Energy's proposed use of five seasonal time bands in allocating costs for tariff setting will increase charging volatility as the weather—especially peak summer temperatures and demand for air-conditioning—will become an important factor year-on-year. We believe this is an unnecessary complication, especially as the vast majority of consumers will not see these cost signals as they will be serviced by at most two-rate meters. As matters currently stand, in the absence of IDNO charges, we would be exposed to a driver we could do nothing to manage.

Priorities moving forward

In our letter to EDF Energy of 19 February we set out four priorities we thought the company should act on:

- “consultation and development on IDNO charges that eliminate anti-competitive margin squeeze and which distort competition, and reflecting Ofgem's recent comments on proposals brought forwards by other DNOs;
- consultation on and development of a new charging methodology, including IDNO charges that appropriately reflects competitive impacts on the wider market, that is stable and eliminates the significant regulatory risks to which new entrants such as ourselves are increasingly being subject.;
- the production of indicative charges for the coming five years that demonstrate that the prospect of margin squeeze will not return; and

- resolution of these issues in a way that interrelates to other developmental issues currently being progressed within the industry (derivation of consistent and appropriate distribution line loss factors, availability of all relevant settlement data flows to all network operators to enable accurate billing and settlement etc).”

We do not believe meaningful progress has been made on any of these issues, and for this reason alone Ofgem should ensure that EDF addresses them properly as soon as possible, and certainly before any change to charging methodologies is implemented.

There are three further implications:

- first we believe this lack of progress should mean that EDF Energy’s request to become licensed as an IDNO in its own service area should be refused. This is not least because, in the absence of IDNO arrangements currently, it would have the opportunity to benefit unfairly from their eventual introduction by shaping them so they give its own subsidiary the greatest benefit to the detriment of competing IDNOs, thereby undermining the benefits we are able to bring consumers through competition;
- second we believe that, if development work by individual DNOs is to continue, these priorities listed above should form the basis of EDF Energy’s work-plan across its three network areas; and
- third, as noted, we would prefer to see EDF Energy’s efforts directed through the common methodology work-stream, which should in turn take on board the priorities we have identified. Collaborative work on a common IDNO charging structure has in fact begun, and the output of this work should be fed into this work-stream for agreement at the earliest opportunity.

I hope these views are helpful and would be pleased to provide more detail and comment as required.

Yours sincerely



David Speake
Regulatory Compliance Analyst
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