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Dear Rachel,

**Consultation on proposals from Electricity North West Limited
to modify use of system charges**

Thank you for the opportunity to provide views on this important consultation about the structure of charges levied by Electricity North West. ESP Electricity owns and operates three IDNO networks embedded in the wires operated by other DNOs.

This response addresses three areas:

- our objectives from DNO use of system charging;
- specific comments on the ENW proposals for IDNO charges as consulted on by Ofgem; and
- suggestions on priorities for Ofgem resulting from issues raised in this consultation.

Objectives from DNO use of system charging

As the operator of a small number of IDNO systems and with the aspiration to increase our presence in the electricity sector, we are most concerned that DNO use of system charges are subject neither to unexpected shocks nor margin squeeze as 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 of seeking to minimise charge disturbance for our existing customers subject to the maintenance of commercial and operational viability of our own very significant investments.

As a consequence we warmly welcome Ofgem's current proposal for a common charging methodology and believe development work by individual DNOs needs to be put on hold while it is taken forward. A common charging approach will be much more manageable for smaller participants such as ESP Electricity.

Specific comments on the ENW IDNO proposals

We believe that Ofgem is right to stress that IDNO charges form an integral part of the development of a common charging methodology. We therefore welcome in principle ENW's proposal to introduce specific IDNO charges ahead of a new methodology and in particular the outlining of a schedule that does not feature capacity charges.

However, we have a number of specific concerns about the ENW proposals:

- **their incomplete nature**: we share Ofgem's concerns that the proposed charges do not incorporate a schedule for commercial developments—we operate two networks with significant mixed use—and also their having no single rate charge option for households even though single rate domestic users form the vast majority of domestic connections especially in areas with gas supplies. We believe that the lack of these two structures is a significant weakness in the proposals, which will act to constrain the competitive activity of IDNOs. Consumers could therefore miss out on important benefits from competition in distribution;



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- **use of a distance-related element:** We are aware that the use of a distance-related element—proposing rates that vary by the distance of the IDNO connection to the nearest substation—is a feature first proposed and subsequently implemented by WPD. We are concerned that the widespread adoption of this structure by DNOs will focus IDNO activity in areas close to existing substations, which will probably be already well-developed and so of limited opportunity. The DNOs seem to have designed this structure to give themselves a huge competitive advantage in the greenfield sector, where we expect most development to take place;
- **avoided costs:** we welcome ENW's recognition that IDNOs help efficiently run DNOs avoid costs in the areas of billing and administration. We also welcome its assessment of a figure valuing that benefit of £14.86, and its commitment to cap its charges in such a way that it will not pass through any extra costs from administering IDNO tariffs should they occur in the short term. We hope that this principle or similar can become an established feature in IDNO charge development within the common charging methodology and potentially the 'interim' proposals under discussion; and
- **margin squeeze:** we note Ofgem's evaluation of the IDNO charges based on end users with a single rate meter (unrestricted supply). The findings of our own evaluation of the charges are broadly consistent with this. But we are concerned that no evaluation appears to have been carried out by Ofgem for the two rate end user tariff structure. Our own estimates suggest the IDNO rates proposed by ENW will result in higher costs than the current maximum demand based structures for low voltage connections where the end users are domestic and served on Economy 7 terms.

Priorities for Ofgem

We believe the following goals arise from this consultation for Ofgem's attention:

- evaluating the margins to the IDNO derived from the IDNO charges as proposed for two rate meters compared with the existing structures, as well as the single rate tariff analysis presented. We believe this will show a fall in IDNO margins compared with the current structure in many instances, which will be detrimental to competition;
- establishing the principle that the IDNO rate on a particular tariff structure will always be lower than the equivalent end user rate. Doing this would avoid the potential for unintended consequences triggering squeezed or even negative margins for IDNOs. The proposed ENW IDNO tariffs incorporate fixed charges that are higher than the equivalent fixed charges for the domestic end user tariffs; and
- ensuring that the development of a new charging methodology, including IDNO charges that appropriately reflect competitive impacts on the wider market, results in manageable charge changes from those currently proposed and eliminates the significant regulatory risks to which new entrants such as ourselves are increasingly exposed to. For IDNO charges, the process should involve the production of indicative charges for the coming five years that demonstrate that margin squeeze and the prospect of it will not return.

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

Yours sincerely

David Speake

Regulatory Compliance Analyst