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22 January 2009

Dear Lewis

Re: Next steps in delivering the electricity structure of charges project

I am writing on behalf of CE Electric UK Funding Company (CE) and its wholly-owned electricity distribution licensees Northern Electric Distribution Limited (NEDL) and Yorkshire Electricity Distribution plc (YEDL). This letter provides our response to Ofgem's recent consultation on the next steps in delivering the structure of charges (SoC) project.

We welcome Ofgem's taking the lead in the future direction of the structure of distribution use of system charges (SoC) project. We recognise the amount of work that has already been put in by Ofgem, by industry stakeholders and by all distribution network operators (DNOs) in this area and are committed to continuing to work together with all relevant parties to progress a common approach to charging that can be utilised by all DNOs.

We believe there is a great deal of merit in Ofgem's specifying a common charging methodology at all voltages, to be applied by all DNOs, even if the approaches at each voltage are different. This would result in reduced development costs within the industry and savings for suppliers resulting from increased transparency and greater consistency in tariff application - which is why we did not oppose the collective licence modification (CLM) that Ofgem proposed in October 2008. Since the blocking of the proposed CLM, DNOs have nevertheless worked to progress substantial elements of the specification, as detailed in Ofgem's 22 July decision document, on a voluntary basis. In particular, we are continuing jointly to develop (in conjunction with Reckon LLP, the electricity networks consultant) a common distribution reinforcement model (DRM) at high voltage (HV) and low voltage (LV) that includes charges for independent distribution network operators (IDNOs); generator charges that recognise the potential for generation to benefit the network by offsetting demand; and a consistent approach to reactive power charging. Although this work only focuses on the lower voltages (HV and LV), we believe that the output will deliver much of the commonality that the industry is looking for and many of the benefits that Ofgem and our customers desire. The DNOs have invested a considerable amount of time and resource since the blocking of the CLM in order to progress work in this area, and it has been disappointing to many that Ofgem has not appeared to engage similarly in that time.

In the consultation paper a number of specific questions are posed - detailed below are our responses to each of these questions.

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Do you consider that Ofgem is right to prioritise delivery of the high-level objectives set out in chapter 2 of the consultation?

We believe that Ofgem is right to prioritise the objectives set out in chapter two of the consultation.

In the consultation paper Ofgem rightly acknowledges that it is difficult to quantify precisely the potential impact that revised charging arrangements would have on the market. However, Ofgem does refer to the fact that a 5 percent reduction in investment at extra-high voltage (EHV) would avoid the need for £100-125 million of investment over the coming price control period: whilst that statement may be true in itself, we would wish for Ofgem to explain its selection of a reduction figure of 5 percent before we could comment on this, not least because customers who have paid connection charges are unlikely to relocate on the basis of DUoS costs alone. In addition, it is misleading to suggest that £2-2.5 billion of investment is due to forecast load at EHV – whilst we agree that this might be the area where the investment occurs, a large proportion of it will be driven by the need to reinforce for load growth much further down the system.

Interestingly, Ofgem describes DUoS charges as a significant barrier to the development of distributed generation (DG) that hinders its responsibility to contribute towards the effort to tackle climate change, even though DUoS charges only represent a small percentage of the final end-user's energy bill. It is our view that generation customers should both bear the costs and share in the benefits they bring to the network - it should be noted that generation customers are currently shielded in their DUoS charge from much of the additional costs of active system management at lower voltages which will be shared amongst all users.

Finally, Ofgem suggests that the lack of implementation of the looked-for changes in charging methodologies might slow down the implementation of smart metering. We believe that the critical enabler to ensure delivery of the smart metering project will be a swift decision on the method of roll-out by the UK government, which we understand is imminent. Once this has been decided network operators will be free to assess the implications of the proposed metering system and ensure that charging methodologies are designed to take full advantage of it.

Given the potential benefits of delivering the project for electricity customers, generators, distributors and suppliers, do you agree that it would be appropriate for Ofgem to continue to pursue the delivery of the project?

We believe there is a great deal of merit in Ofgem's specifying a common charging methodology to be applied across all DNOs, even if the approaches at each voltage are different, hence it is appropriate for Ofgem to pursue the delivery of the project - although the level of benefit that Ofgem ascribes to the project appears to be ambitious. From both Ofgem's and the industry's perspective we can see that the introduction of a common approach to charging for use of the distribution system could reduce the overall development cost within the industry and deliver savings to suppliers via improved consistency in charging mechanisms, tariff structures and tariff application. However, if this is to be the case it is vital not only that we have a common set of rules/principles, but also that we have a common charging model, if any subsequent governance arrangements are to be successful. It is also essential that, when Ofgem decides on the model to be used, it should also specify the approach to be used. The detail and precision specified should be at such a level as to leave no scope for further discussion or differing interpretations.

Do you consider that it would be appropriate for the Authority to refer the package of measures consulted on in its October proposal for a ruling by the Competition Commission? On this question Ofgem invites generators, suppliers and customer groups to confirm which aspects of the October decision would deliver the greatest benefit to them, and where possible to quantify this benefit.

As it was only a blocking minority that objected to the October 2008 CLM we believe that it would be appropriate for Ofgem to refer the package of measures for a ruling by the Competition Commission. However, before doing so Ofgem needs to fully understand which elements of the proposal will deliver the most benefit in the short and long terms and the

likely costs and timescales involved. (It is already too late to deliver a new charging solution at EHV by April 2010 and extremely challenging to implement revised models at the lower voltages. Any referral to the Competition Commission will put the ongoing work at risk and is likely to result in significant costs being incurred). We suspect that the majority of the saving that generators, suppliers and customer groups could extract from these changes would emanate from the consistency in application of tariff structures and charging methodologies for the mass-market customers that are connected at lower voltages. (i.e. a common methodology with consistent tariff structure applied universally throughout the industry; charges for IDNOs; generator charges that recognise the potential for generation to benefit the network by offsetting demand; and reactive power charging). Indeed, the introduction of more cost-reflective, but potentially more volatile, tariffs for the minority (less than half of one percent) of customers who are connected at EHV could introduce unnecessary risks to these businesses in an already unstable economic climate.

Do you consider that it would be more appropriate for the Authority to modify the October proposal by excluding the requirements for a common charging methodology at EHV level, and opening a statutory consultation on a modified proposal to deliver commonality at HV/LV level only?

We support Ofgem's aim of bringing more cost-reflective charging and a more common approach across all network operators. A move to a CLM requirement at HV and LV only would be a backward step in our opinion. We believe it would be better for the industry to consolidate the work done so far on a joint EHV charging methodology, backed by some clear leadership from Ofgem regarding its preferred approach – although we appreciate that this would not be easy to achieve given the differing views from across the industry. It is pertinent to point out that Ofgem's original deadline of implementation by 2010 for revised charging arrangements at EHV already looks to be unachievable. We also feel that any further consultations could put at risk the implementation of a common approach for HV and LV, albeit this has been developed on a voluntary basis.

If you agree that it would be appropriate to consult again on a modified CLM proposal at HV/LV level, do you consider that it would be appropriate for Ofgem to refer its October decision to implement a common LRIC methodology at EHV level for a ruling by the Competition Commission? If you do not agree that it would be appropriate to refer the LRIC decision to the Competition Commission, what option would you recommend to Ofgem to deliver revised charging methodologies at the EHV level?

We do not agree that it would be appropriate to consult on the HV/LV position as this would add further delays to the process and could have an undesirable impact on the ongoing work that is currently being progressed by the DNOs. Hence, we believe that the decision should be referred to the Competition Commission so that clarity on this issue can be achieved.

Are there options that Ofgem has not considered for ensuring delivery of the structure of charges project and, if so, what are they?

We are not aware of any other option that Ofgem should consider at this stage.

In summary, we welcome the stance that Ofgem is taking in leading the future direction of the long-term charging arrangements, although the deadlines for implementation will need to be reviewed given the unfortunate and unforeseen delay in proceedings resulting from the blocking of Ofgem's October 2008 CLM proposal. I trust this response sets out our views sufficiently and would stress again that we would welcome the opportunity to discuss these views with Ofgem. We would also be willing to participate in any groups that are established to take forward developments in this area.

Yours sincerely

H Jones

Harvey Jones

Head of Network Trading