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23 January 2009

Dear Rachel,

Next steps in delivering the electricity distribution structure of charges project

Thank you for the latest consultation on the structure of charges project which sets out the possible next steps following the blocking of the Collective Licence Modification (CLM). We believe that the main priority now is to deliver revised charging arrangements as quickly as possible and the next steps should focus on this objective.

We have always supported the introduction of new charging methodologies which better meet the relevant objectives and encourage users to connect to and use the distribution network efficiently and we can see the potential that they can support steps to reduce the UK's carbon emissions. In considering the overall charging methodology this must include both charging for connection to the system and for use of the system. We do not believe it is appropriate to look at use of system charges in isolation from the total charging message that customers face. Variations in connection charges potentially have more impact on locational decisions than variations in use of system charges.

We have previously opposed, in principle, the proposal to move to a common charging methodology as we believe that such a move would reduce our ability to innovate and determine solutions to the issues which we face, but more importantly that it would result in a delay in delivering the primary objective of modified charging arrangements. The justification for the common charging methodology is on the basis that a common methodology would benefit customers by reducing the risk premium suppliers apply to distribution charges. We note that there has been no evidence to support this assertion in any of the documents, nor any proposals on how any reduced costs would be passed on to customers. The primary drivers outlined in your paper for the structure of charges project do not require a common approach and can be delivered by each DNO individually in accordance with the current licence conditions.

The DNOs are now working together on key aspects of charging, in particular, the approach to be used for HV/LV charging. We have established a Common Methodology Group and

appointed a consultant to support this process, which is basically the same approach that would have emerged had the CLM not been blocked. The groups also include representatives from other stakeholders such as suppliers and generators. We believe this work should continue. The approach being proposed to HV/LV charging is similar to the approach we advocated in our latest modification proposal and outlined in the CLM. In order to make progress we will, therefore, continue to support this process and adopt the common methodology that is developed through this process.

Our suggested way forward recognises the importance of the structure of charges project and our desire to resolve this issue in time for new charging arrangements to be in place for the start of the next price control which is the stated key driver. We therefore propose:

- (a) The DNOs continue to work together informally in the Common Methodology Group to deliver a common charging methodology for HV/LV.
- (b) That each DNO brings forward a methodology change, on a co-ordinated basis with the other DNOs, when the common methodology is finalised in line with the current licence conditions.
- (c) The common charging method would specify how the marginal costs to be determined at EHV would be included in an overall charging methodology.
- (d) Each DNO to bring forward proposals for the determination of EHV marginal costs based on power flow analysis.
- (e) Governance arrangements would be considered for the common methodology following its development.

The decision to move to a common charging methodology appears to have been primarily driven by Ofgem wanting to impose the Bath/ WPD LRIC charging model at EHV on DNOs, which we believe does not reflect costs and can produce excessive charges which can breach competition law. This was acknowledged by Ofgem in the CLM proposal. If Ofgem continues with this requirement, which was not supported by generators or suppliers in the consultations, then the issue must be referred to the Competition Commission for investigation.

With regard to the specific option set out in the paper.

Option 1. Refer to the Competition Commission. We believe that this is an unnecessary distraction and diverts resources away from the primary objective delivering new charging arrangements. However, Ofgem must pursue this route if it wishes to impose the LRIC charging approach on the industry.

Option 2A. CLM for HV/LV and do nothing at EHV. This is similar to our preferred approach but we do not see any need for a CLM at this stage. Considerable time and

effort was required to develop the originally proposed CLM and developing a further licence modification which is able to affect only part of the methodology may not be possible. Much of the previous CLM was focused on the process for developing a common methodology and this objective is now being achieved without the need for a CLM. Introducing a further CLM at this stage focussed on mandating a common development process will divert resources away from the development and delivery of the charging methodology itself. We would support, however, the development of future governance of the common charging methodology which would not interfere with the progress that is currently being made. This could be similar to the approach used for the DCUSA which was developed prior to the licence modification to implement it being introduced. A new CLM on implementing the common methodology could be introduced in a few months time when the development work is nearing completion.

Option 2B. CLM for HV/LV and refer LRIC to CC. As for Option 2A we do not see the need for a CLM at this stage. We would expect any Competition Commission referral to be wide ranging and we therefore support Ofgem's conclusion that such an approach would be unwise as it could undermine the good progress at HV/LV that is currently being made.

Option 2C. CLM for HV/LV and all LRIC/ FCP at EHV. This is similar to option 2A but we cannot see the need to be prescriptive on the use of only LRIC/ FCP at EHV.

As you can see our preference is to introduce new charging arrangements as quickly and pragmatically as possible without further delay. We believe that the best way of achieving this is for a continuation of the joint DNO work on HV/LV charging to be implemented through the existing licence conditions. Future governance arrangements can be explored now, but a decision on a new CLM being introduced to formalise this aspect of the methodology, should be delayed until the effectiveness of a governance process with only partial coverage of pricing methodologies has been proven. Whilst, we still have some concerns on the practicalities of the EHV and HV/LV aspects of the charging methodologies being covered by different governance processes, we will work with you and other DNOs to see if this can be achieved.

For EHV we believe each DNO should bring forward its own proposals which should be considered by Ofgem against the current licence conditions. We do not believe that there is any justification for further Collective Licence Modification covering EHV methodologies at this stage. Should Ofgem decide that it wishes to impose a common charging methodology that includes LRIC, it needs to refer the issue to the Competition Commission. We are prepared for such an eventuality and will provide detailed evidence to the Competition Commission on this issue. We can see merit in such a referral to resolve this issue finally, but we believe that the approach we have identified makes better use of resources and will deliver the new charging arranging arrangement with the resulting benefits in time for the start of DPCR5.

We can see benefit in the whole EHV charging arrangements being looked at again after the implementation of new arrangements in April 2010 to look to resolve the LRIC issue, following a similar process to that which the Competition Commission would follow. This could involve the appointment of independent economic consultants to review the issues and approaches and make recommendations on the way forward.

I hope you find these comments constructive and I look forward to your decision on the next steps. In the meantime if you wish to discuss at aspect of our proposal please contact either myself or Tony McEntee on 01925 534499.

Yours sincerely,

Paul Bircham
Regulation Director