

Andy MacFaul
Head of Better Regulation
The Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

98 Aketon Road
Castleford
West Yorkshire
WF10 5DS
tel (01977) 605938
fax (01977) 605811

andrew.macfaul@ofgem.gov.uk

27 February 2009

Dear Andy

Proposed Corporate Strategy and Plan 2009-2014: Ref: 02a/09

Thank you for giving us the opportunity to comment on your Proposed Corporate Strategy and Plan 2009-2014 (the *Corporate Strategy paper*). Overall, we hold to the views that we shared in our response to Ofgem's Five Year Strategy letter of 21 August 2008 which outlined in our view what the challenges and priorities that Ofgem and the energy market will face in the coming years.

We maintain that with the uncertainty and volatility in the capital markets, public sensitivity to energy price rises and the increasing environmental pressures to meet the challenge to transition to a low-carbon economy, Ofgem will need to ensure through the appropriate mechanisms that the networks are maintained and improved with improved services provided to consumers at appropriate cost while encouraging the sustainable development of networks.

In the *Corporate Strategy paper* you list the following seven themes that are fundamental to your strategy:

1. Creating and sustaining competition
2. Regulating networks effectively
3. Helping to achieve sustainable development
4. Helping to protect the security of Britain's energy supplies
5. A leading voice in Europe
6. Helping to tackle fuel poverty
7. Better regulation

We recognise that there is potential overlap between this corporate strategy development work and the Distribution Price Control Review 5 (DPCR5) and RPI-X@20 programmes of work. In responding to the *Corporate Strategy paper* we have focussed on the themes that are most relevant to distribution network operators. In the list above we suggest that these are themes two, three and four; although we do also touch upon the smart metering aspect of theme one. The principle of our response is the importance of defining roles and responsibilities within the industry and introducing the appropriate incentives to drive the development of more effective networks and enable businesses to be more responsive to customers' needs.

CE ELECTRIC UK FUNDING COMPANY

Registered Office: Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF

Registered in England and Wales. Registered Number: 3476201

If you would like an audio copy of this letter, a copy in large type, Braille or another language, please call 0800 652 6543

Roles and responsibilities

We share Ofgem's aim of having distribution networks that facilitate the wider transition to a low-carbon economy. We expect a 21st century electricity network to be characterised by changes in the pattern of consumption and demand, in particular by an increase in local trading. It is clear to us that the way in which networks are used could change dramatically: it is less clear that the way those assets are operated needs to change so significantly.

This could see radical new approaches like virtual power plants used by energy service companies (ESCOs) to balance their sources of energy production and consumption in local trading, by aggregating and despatching load and generation. This would be an intelligent layer over a physical network that evolves more slowly in response to these new power flows.

We note that the draft strategy states that (at paragraph 2.22):

'...as part of DPCR5 we will set out a framework to allow the role of DNOs to evolve in response to changes in network use which might come about as a result of more distributed generation, smart meters, zero-carbon homes or electric vehicles for example. Once the next price control has been settled we will...establish how the DNOs' role might develop in the medium-term in order to tackle climate change and ensure secure energy supplies.'

We agree that distributors need to respond, and that networks need to change in response, to these new opportunities. We welcome Ofgem's commitment to introducing a framework to facilitate this. We agree that the proposals in the DPCR5 policy paper for funding innovative investment will support development of new techniques, up to and including 'Smart Cities'. However, these more radical trials require ground rules to be set (even if only on a local and temporary basis) for new market designs.

We welcome the statement (at paragraph 3.32) that Ofgem:

'...will continue to work with all stakeholders to identify barriers hindering the shift to a low carbon energy system...'

We urge Ofgem to deliver on this promise by leading a debate on roles and responsibilities. This is an issue of market design, and therefore falls to Ofgem, rather than a detailed issue of code modifications or of network design, which would fall to the industry.

This debate must be holistic, which is why only Ofgem can lead it. In an evolving energy market, actions by any one player will affect all others. For example, despatching load or generation will affect end-users, distributors, suppliers (including ESCOs where appropriate), GB system operator (GBSO) and generators.

This debate must happen now. Defining roles and responsibilities affects every current debate from smart meters to transmission access. For example, distributors', suppliers' and GBSO's detailed requirements for demand response are very different. Distributors require despatch of small groups, perhaps a few thousand customers below a given primary substation. Suppliers require despatch of larger groups, perhaps all customers on a given tariff in a given transmission charging zone. GBSO generally requires a single, national response.

Similarly, the only point of introducing new commercial arrangements for transmission access is to encourage efficient management of power flows: therefore, the consistent approach is to make the lead player in demand response the agent for transmission access rights for embedded end-users.

If we fail to have this debate, the allocation of roles and responsibilities will be made piecemeal, carrying a risk to the coherence and timeliness of the end result. Without a holistic view at the start, the result is likely to be internally inconsistent and unlikely to deliver the most efficient solution. Costs and carbon emissions will be higher than they otherwise might be. Decisions that will be taken soon include:

- choice of agent for transmission access for DG; and
- funding routes for energy efficiency etc. services.

As part of this debate, we welcome the forthcoming publication of Ofgem's '...views on the potential implications of the [LENS] scenarios for the networks and the way we regulate them...' (paragraph 2.14).

The LENS conclusions as they stand are too high-level directly to inform decisions on managing the distribution businesses. We need to identify what each scenario might mean for distribution networks, to identify common themes for 'no regrets' investment. This would encompass research and development into, and subsequent trials of, the new techniques we might require to accommodate changing power flows as the need arises.

It is also essential to test the LENS scenarios against other views of the future, such as the Renewable Energy Strategy (RES), Heat and Energy Efficiency Strategy, zero-carbon homes, etc. For example, we note that the LENS scenarios are inconsistent with the volume of wind generation foreseen by the RES. This is particularly important for medium-term planning to 2020 or so, as it is the current and proposed suite of Government policies that will directly affect the way that customers seek to use our networks.

Incentives for more effective networks

To assist a culture change within distributors to make them yet more responsive to customer need, we propose that Ofgem introduce at DPCR5 explicit incentives to seek out new business. We therefore welcome the statement (at paragraph 3.11) that Ofgem will:

'...seek to introduce new measures to encourage DNOs to connect renewable and other low-carbon distributed generation...'

We contend that measures '...to encourage DNOs to connect...' must be genuine incentives, not just cost recovery. Such measures should also apply to load as well as to generation: we note that Ofgem have already proposed as part of DPCR5 a per-customer revenue driver, which could meet this need. Such measures should be backed up by incentives to efficiency in operation, including all the costs of providing new connections. We welcome the commitment (stated at paragraph 3.6) for Ofgem to strengthen incentives for distributors to invest in innovative technologies. Research and development is essential for distributors to remain responsive to customer needs, and to deliver ongoing efficiencies in meeting those needs. We have provided detailed proposals for each of these areas in our response to the DPCR5 policy paper.

Pure networks

We agree that the areas that Ofgem should address include:

- visual amenity (paragraph 2.21);
- 'worst-served' customers (paragraph 2.21);
- output measures (paragraph 2.22);
- reporting reform (paragraph 2.23);
- charging reform (paragraph 2.24-25); and
- competition in connections (paragraph 2.29) and distribution (paragraph 2.28).

We also submit that Ofgem should consider oil and noise pollution as part of DPCR5.

We were surprised that there was no explicit reference to business carbon footprint in the draft strategy. We agree with the view expressed in the latest DPCR5 policy paper that this is a relevant issue for distributors. We urge only that the framework be proportionate.

We have provided detailed proposals for each of these areas in our response to the DPCR5 policy paper. We also continue to be engaged with the relevant Ofgem staff to clarify and work towards solutions in each of the areas identified. However, if you have any questions arising from this consultation response, please do not hesitate to make contact.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jim Cardwell', written in a cursive style.

Jim Cardwell
DPCR5 Programme Manager