



FAO
Distribution Network Operators

*Promoting choice and
value for all customers*

Your Ref:
Our Ref:
Direct Dial: 020 7901 7194
Email: Rachel.Fletcher@ofgem.gov.uk

Date: 3 June 2009

Dear Colleague

Structure of Electricity Distribution Charges: Collective Licence Modification

On 22 May 2009 I met with members of the regulatory teams of most of the DNOs on the structure of charges project. The purpose of this letter is to reiterate what I said at the meeting in relation to proposed standard licence condition 50 (SLC 50) in the Collective Licence Modification (CLM) which is currently out for formal consultation. The CLM proposal is to require all DNOs to implement a common charging methodology and open governance processes for the low voltage network by 1 April 2010.

I called the meeting in May to better understand whether I had full support from each DNO for the low voltage elements of the structure of charges project, timely delivery of which remains a very high priority for Ofgem. A number of events during the development of the CLM called into question commitment at a senior level within the DNOs to delivering the project, notwithstanding the significant effort being expended across the industry at a working level in developing the common methodologies. At the meeting the DNO representatives assured me that the senior teams of the DNOs collectively are fully supportive of the project, are firmly committed to delivering the project to time and remain confident that the deadlines set out in the CLM proposal are achievable.

One of the events that caused me concern was the suggestion late in the development of the CLM that it may not be acceptable for DNOs to face an absolute obligation to deliver a common methodology, as this could lead to a DNO being in breach of the licence through actions of another DNO. While the current CLM uses identical text to the CLM we consulted on in October last year, I am willing to accept the explanation that the DNOs did not fully appreciate this aspect of the proposal until recently and accept that DNOs may have genuine concerns about the proposed licence formulation. We are responding separately to the process matters that arise from the DNOs' letter to Michael Brocklehurst on this matter.

With a view to addressing your concerns, I can assure you that the purpose of the CLM is not to set the DNOs up to fail. As our recent decisions have demonstrated, we would prefer not to deliver common charging methodologies through taking enforcement action. Our strategy at this point is to create a regulatory framework that facilitates DNO cooperation in delivering common charging methodologies to specific timelines. Proposed SLC 50 has been drafted with this in mind. We have used this formulation in the past with regard to

implementing DCUSA where it was accepted by DNOs and successful in delivering the related project outcomes. We consider this text is appropriate for what is a time-limited collective obligation and is reasonable given the progress DNOs have already made on a voluntary basis towards a common methodology.

As I noted at the meeting, the history of this project and the difficulty we have had in the past in achieving agreed deadlines means that it is not appropriate to qualify the obligation on each DNO to deliver this collective outcome. Any qualification of proposed SLC 50 will reduce the effectiveness of the licence framework we are trying to create, will make it easier for individual DNOs to walk away from the process if there are difficult decisions to make and will reduce the chances of the DNOs delivering to the required timelines. For the avoidance of doubt and for the reasons set out above, we do not intend to amend the CLM or issue a section 49A notice (as proposed by Roger Barnard).

I understand the legal point that in accepting the CLM there is the potential for your company to be in breach of the licence through no fault of your own. You asked for assurance on what actions we would take in the event the common methodology is not delivered despite the best efforts of individual companies.

In this event we would look to assess what steps each company has taken to deliver the project objectives. If individual companies have made every effort to deliver the common charging methodology including providing resources to the project and taking all steps (including escalation within the DNO in question) to influence their colleagues to ensure delivery, then it would be unreasonable of us to impose a financial penalty for licence breach against those particular companies. In these circumstances we would expect you to provide the evidence to demonstrate the full range of actions that you have taken. It is not our intention to penalise companies who have made every effort to ensure delivery of the common charging methodology.

I trust that this provides sufficient clarification on our intentions to enable you to consent to the CLM.

Finally, it is important to reiterate Ofgem's commitment to achieving the objectives of this project through whatever means necessary. As noted above, we would like to do this by creating a licence framework that supports the successful completion of the joint work the industry has commenced. We are committed to providing the Ofgem resources and guidance needed to make this work a success. However, if we do not receive DNO support for the CLM which is currently out for consultation we have not ruled out a reference to the Competition Commission. In this event we will also have to consider the implications for the DPCR5 settlement, as we signalled in our December DPCR5 Policy Paper.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Rachel Fletcher', is positioned above the printed name.

Rachel Fletcher
Director, Distribution