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Dear Martin

Review of Competition in Gas and Electricity Connections: consultation

energywatch welcomes the opportunity to respond to the issues raised by this consultation. This response is non-confidential and we are happy for it to be published on the Ofgem website.

General comments

We believe that competition in connections works best if consumers are given an effective choice of provider, matched by effective regulation of that provider in meeting agreed, formal and benchmarked minimum standards of performance, with appropriate recompense for consumers where the provider fails to meet those standards. Connections must be provided economically. We believe that there are certain requisites for a competitive market in connections:

- consumers must be given clear and transparent information about the works to be undertaken;
- there should be an itemised estimate of the works to be carried out that consumers can compare with the works as undertaken and an itemised bill on the completion of works;
- the benefits of efficiency savings arising from single connections to multiple sites (a new housing estate) should be visible to and shared with end consumers; and
- there should be a non-discriminatory approach to the tendering process for connections works, ensuring the same information is available to all providers.

These are some of the ways in which the benefits of competition may be realised by consumers. We would like to see the expansion of competition in connections to areas where this does not exist currently but only if there is the prospect of real competition – sufficient competitors with expertise, and transparent and effective mechanisms for delivery. The requisite aspects of competition we have outlined above must be seen to be operating effectively now and as part of any package of measures should competition be expanded to other sectors.

We note the largely successful implementation of competition in gas connections. However, Ofgem acknowledges that providers have needed to observe formal standards of performance to make competition successful. We also consider that some providers, specifically independent gas transporters (IGTs) have created other issues for consumers which Ofgem needs to address through appropriate regulation. In electricity connections, there is not just limited competition which leaves most contestable sectors largely in monopoly hands but there are potential discriminatory blocks to effective competition.

Developers and house builders who seek utility connections are key consumers when considering the development of competition in connections. However, recent evidence suggests that many builders are either unaware of competition or have encountered real difficulties, particularly in obtaining electricity connections, which illustrate the lack of development of a competitive market.

We will discuss these various issues in further detail below.

Competition in gas connections

There appears to be a flourishing market in competitive connections in gas, particularly in new domestic connections, with increased involvement from independent connection providers (ICPs). While we welcome the increased competition to existing gas distribution networks (DNs) that ICPs provide, we believe that consumers still do not obtain the full benefits of that competition. This is most prevalent in terms of the additional transportation charges imposed on consumers who are connected by IGTs, or by ICPs whose connections are taken over by IGTs (specifically new housing estates).

Any financial savings made by the developer of a new housing estate through a competitive connection are not necessarily visible to the end consumer when the new home is purchased, meaning that it is not transparent whether any benefits have been passed through. However, the end consumer discovers the costs of an ICP or IGT connection very quickly once their gas supplier levies an additional gas transportation charge in bills. This highlights a real concern – that end consumers require more transparency about the total future energy bill and any potential for energy savings associated with purchasing a new property. Any benefit to the developer of a competitive connection may not necessarily filter to the end consumer.

It is noticeable that competition is not widespread. The 2005/06 Connections Review highlights that the existing domestic gas connections sector and non-domestic connections are still significant monopoly markets for the gas DN. Ofgem must recognise that the benefits of competition are not so widespread and that there remain significant areas of the gas connections market where further progress needs to be made. The statistics simply highlight that there are certain sectors which can be 'cherry-picked' by new entrant ICPs and IGTs and that the bulk of other connections remain with incumbents. If this remains the case well into the future, consumers require reassurances that effective regulation and enforcement will be in place until these sectors show real signs of market penetration by independents.

Energywatch has a particular responsibility to low income consumers and those in rural areas. We believe that consumers in 'off-gas' communities are poorly served, thereby being denied access to cheaper fuel for heating and cooking. We would encourage exploration by Ofgem and the industry of ways in which more 'off-gas' communities can be connected. The removal of the 10 metre rule has been suggested as one way forward so that more ICPs become involved in one-off domestic gas connections. However, this relaxation of the rules must be attractive to increase competition, and the incentives provided to new entrants must be appropriate. If necessary, charges may need to be capped to prevent over-recovery from consumers and we look forward to seeing further details as part of the enduring gas price control proposals. In any case, shared benefits of effective competition need to be delivered to consumers through the price control and we will be keeping a close watch on the forthcoming proposals to ensure this is achieved.

It has been suggested that there are other sectors of gas connection, such as pipeline diversions, which could be opened to further competition. Our criteria for effective competition stated above should be addressed if further sectors are opened to new entrants. Furthermore, if the cost-benefit analysis suggests that sectors ought to remain under monopoly control, these should be subject to effective regulation, with measurable formal standards of performance for providers, to ensure that consumers are treated appropriately. We also expect to see these matters dealt with through the enduring gas price control.

Competition in electricity connections

We agree with Ofgem that competition in electricity connections is extremely limited and that the failure of real competition to develop in any of the voltage sectors should encourage effective regulation and enforcement rather than leaving monopoly businesses to continue to offer a poor service to all types of consumer. The statistics in the 2005/06 Connections Review highlight the extent to which incumbent distribution network operators (DNOs) and their affiliated businesses have a stranglehold on the market, in some sectors increasing their market share year-on-year. As the value of electricity connections is higher than for gas connections, the lack of competition currently provides a reasonably secure revenue stream for the DNOs.

A significant reason for the lack of effective competition must be the failure to adopt either formal standards of performance or effective compensatory mechanisms which prevent consumers taking firm action against the relevant DNO for delays and poor service. As information, design services, investment priorities and final connections largely flow through the DNOs, they are essentially able to set the pace for processing connections applications made by consumers, in particular developers, which can limit or hinder effective competition. This manifests itself in behaviour that is more characteristic of a monopoly where the incumbent sets all the terms, rather than of a competitive market where the purchaser has the right to expect a level of service that is responsive to his legitimate commercial needs. There are a number of areas where problems exist:

- the lack of transparency and detail in quotes for connections work, and lack of awareness of the commercial timeframes associated with connections for non domestic consumers and developers. Delays and no commitment to firm timescales for delivery by the DNO can have a knock-on impact on the service provided by an ICP where it is involved in the connection application;
- the potential for affiliates of DNOs to quote for work in competition with ICPs with possible discriminatory treatment regarding access to information during the tender process which may provide the affiliate with an advantage;
- the lack of formal standards of performance which make it difficult for consumers to hold DNOs to account if a connection is delayed, is not clearly defined in terms of works to be undertaken, or if additional monies are sought; and
- the ineffective regulation of monopoly businesses in areas of connections where competition is extremely slow to develop.

Performance standards – electricity connections

Without some formal standards of performance, it is difficult to judge how effectively DNOs are performing in comparative terms in any year. In addition, it is difficult to measure whether there is any real improvement in performance by any one DNO, in comparative terms, year-on-year. Therefore, it is difficult to answer Ofgem's questions about the current effectiveness of actual performance. It is the lack of transparency which is also a significant defect of current arrangements.

A scheme for formal standards of performance must be comprehensive and consistent across DNOs in terms of coverage of the main aspects of a connections application. DNOs must provide a quotation against a feasible timescale, determined on the basis of current best practice. The quotation ought to be sufficiently detailed for the consumer to understand the costs involved and how these costs are broken down. There should be a standard for delivering each of the simple, complex and complicated schemes highlighted in the consultation. There should also be a standard for the next steps in the process, namely, the design services required to deliver the scheme and the final connection. Standards should be measured against best practice underpinned through appropriate benchmarking.

The standards need not be overly complicated. In fact, reasonably simple standards would be easy to understand both for the provider and for the consumer or ICP. There should be an effective compensatory mechanism developed in cases where there is a failure to deliver agreed standards. In the absence of agreement, Ofgem may need to be involved in an appropriate dispute resolution capacity.

Transparency issues – electricity connections

Ofgem highlights the need for transparency of information. As DNOs are the sole providers of non-contestable information, it is critical that they must ensure that the provision of data is as smooth as possible, with sufficient detail to allow consumers

to make effective comparisons with the actual work which is undertaken. Best practice should draw out whether there are typical charges for non-contestable work and whether a price cap should apply where a particular DNO exceeds the defined level.

The level of data provided should also be consistent across connections applications, regardless of whether they are competitive or statutory quotations or of their physical location. Housing developers in particular have indicated that they have to wait until receipt of planning consent before receiving quotations and even then these can be incomplete or poorly specified. DNOs must recognise that these parties are their customers in the processing of applications and that, unless there is a real prospect that the planning application will fail, early work on quotations ought to be undertaken.

We are also concerned that the provision of information may not be undertaken in an even-handed manner. This is quite possible where an affiliate of the DNO and an ICP are competing for business, specifically in the same distribution area as the incumbent DNO. In that case, the ability of confidential data to be passed inappropriately is a real concern. It is not entirely inconceivable that the lack of penetration of competitive connections markets by ICPs may be in part due to the way that non-contestable data is handled. The DNOs should be more effectively regulated to ensure that non-discrimination provisions in licences are applied and, if it can be shown that there is still a residual risk of abuse, there may be a case for effective business separation. Ofgem must obtain more data reported directly from the DNOs to verify that there is no ongoing discriminatory practice.

Scope of contestability – electricity connections

Before Ofgem seeks to increase the scope of contestable services, the effectiveness of competition in sectors which are currently contestable must improve. We feel that Ofgem should address the areas of defect highlighted above before seeking further expansion of the competitive market for electricity connections. At the very least, if the scope of the contestable services were to increase, this must be done by ensuring the same problems do not arise for these services. Some of the remedies for current defects will need to be applied to ensure that future contestable services are rigorously regulated as effective competition develops. We would be supportive of greater effort between DNOs and IDNOs to address the key problems through workgroups or other interfaces. However, the purpose must be to create effective mechanisms and processes for measuring the effectiveness of performance and improving competition.

We understand that there may be scope for more contestability in transmission connections but it needs to be clear whether there is sufficient expertise elsewhere to compete with incumbent transmission network owners to build and operate these networks. We are also concerned that any competitive transmission connections are delivered on an efficient and economic basis. The framework for delivery must encompass properly addressing any constraints issues which arise for power flows across the grid and ensuring reliability and security of supply.

Other comments

We have highlighted above a number of reasons why we believe that either more effective competition or more effective regulation and enforcement is required for both gas and electricity connections. However, for a significant consumer of connection services, the property development and house building sector, these problems are real and practical. Recent surveys (carried out over summer 2006) by the National Federation of Builders (NFB) and the House Builders Federation (HBF) illustrate some of the difficulties with obtaining utilities connections for new build estates:

- HBF members, asked to rate utility companies for provision of connections, gave low satisfaction ratings to electricity companies (only 3% rated as 'best')
- NFB members indicated that 50% of sites suffered a delay because of poor performance by the electricity companies
- the majority of NFB respondents felt that standards of service in water, gas and electricity had either stayed the same, or worsened compared to a year ago
- the majority of NFB member sites had not heard of Regulators' plans to introduce connection competition
- of those that had heard of competition, 36% of had used it for electricity, 44.2% had used it for gas, and 21% had used it for water
- of those that had used competition, only 18% said that it improved water connections service levels, 37% for gas and 31% for electricity.

These statistics highlight the practical difficulties observed by key users of connection services. Developers and builders need to be treated as consumers to address these concerns.

Going forward, we will continue to keep under review further progress in the work on competitive connections as and when this is raised, always considering the possible impact on consumers.

We would appreciate being kept informed of the progress of the consultation and any related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs