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5 October 2011

Dear Rebecca

Consultation on Electricity North West Limited's Competition Notice

Thank you for giving us the opportunity to comment on the competition notice submitted by Electricity North West Ltd (ENW).

Given that we have no direct experience of the market (as either a connection provider or electricity distributor) within the ENW distribution services area we are not in a position to comment from experience on the service provided by ENW or on its processes and procedures. As a distribution network operator (DNO) that is also currently preparing its own competition test notice we will, however, comment on ENW's overall notice and its methods for presenting its market share analysis.

ENW's notice appears to us to be comprehensive; it covers all the areas that the licence requires and that were anticipated at the last price control review (DPCR5) as being relevant to a decision of the Gas and Electricity Markets Authority (the Authority) on a competition assessment.

Broadly speaking we agree with the approach to the notice submitted by ENW that was signalled in Ofgem's consultation. In particular, we agree with the focus on whether actual competition or the threat of competition, as opposed to price regulation, can be relied upon to protect the consumer interest. We also agree with Ofgem that, whilst an analysis of market share is an important component of the competition assessment, this should not be considered in isolation from other evidence as it can be an imperfect indicator of the effectiveness of competition. We further agree with Ofgem that a DNO may retain a high market share by providing a high quality of service at a competitive price. In that case, the threat from

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competitors may be effective in limiting the prices the DNO charges and encouraging it to innovate and improve service levels. Accordingly, we agree that the presence of a high market share in a relevant market segment (or a part of a relevant market segment) should not itself be regarded as a decisively negative consideration in the competition assessment. Moreover, Ofgem is right to be mindful of the distorting effect of continued regulation in contestable services which can have unintended consequences and stifle the scope for customers to benefit from competition. We therefore agree with Ofgem that an approach that looks narrowly at market share, or that presumes that price regulation should be retained until pre-defined thresholds have been met, may not be in the best interests of customers.

ENW draws attention to the fact that there is evidence from Ofgem's connections industry review (CIR) publication that indicates ENW has lost more market share than other DNOs. We have no reason to doubt the accuracy of this data and we believe that it is legitimate for ENW to point to this data as evidence of the absence of barriers to entry in the connections market in its distribution services area. However, it does *not* follow from this that there must be fewer barriers to entry in ENW's area than there are in the distribution services areas of other DNOs. In particular, Ofgem will be no doubt aware that the corporate history of ENW may have contributed to this loss of market share. For example, after the sale of ENW, United Utilities continued to provide electricity connections through its subsidiary United Utilities Infrastructure Services, which it has now sold to Veolia Water UK. Other DNOs which have not undergone the corporate restructurings of ENW could still retain a higher market share within their distribution services area even if barriers to entry were no higher than in ENW's distribution services area.

Ofgem asks whether interested parties agree with the assertions made by ENW in its analysis of the level of competition in its distribution services area in each of the relevant market segments. In particular, Ofgem asks whether interested parties consider that the data provided by ENW gives a clear indication of the current level of competitive activity in each of the relevant market segments. We provide our views below about the way the analysis has been constructed by ENW and the issues associated with it.

We agree with ENW that it is now reasonable to focus on the relevant market segments, as defined in the licence, rather than upon the old CIR categories. This avoids problems associated with the CIR data. For instance, the CIR included data on service alterations, which are non-contestable and therefore can only be undertaken by the DNO who operates in the relevant distribution services area. The CIR also failed to differentiate between those

connections market segments in which Ofgem has stated competition is unlikely to be viable now or in the future (small low voltage works), and those where a regulated margin has been allowed.

The time-lag that is present in both the CIR data and in the data collected in the RRP process also presents a problem of interpretation in a competition assessment, as connections are counted only once the DNO finally adopts or energises the end user's service connection. This lagging count does not provide a meaningful view of market activity at the present time. Distributor innovation, industry development and the measurement of the extent of competitive activity today need to be tested against an analysis that reflects the most current view of customers' decisions. ENW's method of providing this more up-to-date reflection of the current market place uses data based on projects that have been accepted rather than waiting for the actual connection works to take place. This is sensible.

We agree with ENW's use of 2kW per property to estimate the number of independent distribution network operator (IDNO) connections. In our experience when an IDNO makes a connection application it will not generally provide full details of how many connections will be made downstream from the connection to the DNO's network. However, the IDNO is required to advise the DNO of the load requirement for the connection. The use of 2kW per plot to derive the number of connections from the requested load is reasonable as the value is widely acknowledged and used for the calculation of after diversity maximum demand (ADMD) on developments that comprise domestic gas heated properties.

Ofgem asks whether, considering the market share currently retained by ENW and the number of independent connection providers (ICPs) currently active in each of the relevant market segments, interested parties consider that competition in each of the relevant market segments is at a level that, in itself, indicates that effective competition exists. We have drawn attention above to the limitations of an analysis that is overly reliant on market share as an indication of the effectiveness of competition. For example, Ofgem may wish to consider whether there are any connections providers who do not currently operate within ENW's distribution services area but could easily do so in the future. If this is the case, it would be direct evidence that the market share data alone does not fully represent the level of effective competition. In addition it is relevant that, in some market segments for which ENW presents data, its market share has been decreasing at the same time as the recession has led to a fall in total connections activity. There are enough competitors for customers to seek competitive alternatives should they wish to do so. It is our view that customers are now generally aware

of competitive alternatives and the options open to them. This is particularly true of repeat order customers such as house builders, local authorities, and developers. Moreover, we contend that it is not only the activity of ICPs that is relevant to the analysis. The significance of the presence of IDNOs in this market should not be underestimated, bringing as it does a different form of competition.

I hope that you will find these comments helpful: should you have any questions arising from them, please do not hesitate to make contact.

Yours sincerely

A handwritten signature in black ink, appearing to read 'S. Wilson', with a long horizontal flourish extending to the right.

Sarah Wilson

Performance Analyst, Regulation and Strategy