

Consultation

Proposal to review competition in the electricity connections market for RIIO-ED2

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Contact: James Veaney

Team: RIIO Electricity Distribution

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Email: RIIOED2@ofgem.gov.uk

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1. Executive summary

- 1.1. We set price controls on the companies that operate the electricity networks in Great Britain (GB) to ensure that current and future consumers receive the network services they require at a fair price.¹
- 1.2. The next round of price controls for the electricity Distribution Network Operators ('DNOs') will start (RIIO-ED2) in April 2023 and will run until March 2028. As part of this process we will set outputs and incentives on the service that DNOs provide. These include the service provided to customers requiring a new connection to the electricity networks.
- 1.3. This document is a consultation paper on our proposal to review the level of competition in the electricity distribution connections market ahead of RIIO-ED2. In this way, our design of RIIO-ED2 outputs and incentives for the connection services provided by DNOs will take into account the levels of effective competition in different parts of the connections market.
- 1.4. We propose to:
 - assess the levels of competition in certain parts of the connections market where we have previously not seen evidence of effective competition; and
 - base this review on what we consider are the key indicators of effective competition. This information will be collected through a data template (see Section 5 for more details).
- 1.5. The outcome of this review will inform the extent to which we apply financially incentivised outputs to connection services in RIIO-ED2. Depending on our findings, we may also make changes to provisions that enable DNOs to charge connection customers a margin in addition to their costs for connection services.

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

- 1.6. Although this may result in different regulatory arrangements applying in different market segments, in all instances there are underlying obligations under the Act² and the licence that provide protection for connecting customers.
- 1.7. The primary aim of this review is to identify in which market segments there is effective competition. We are not undertaking this review to identify if there are any potential breaches of competition law / anti-competitive practices by network companies.³ We will continue to monitor each DNO's compliance with competition law and take seriously any evidence of anti-competitive behaviour.⁴
- 1.8. If we consider it appropriate, we may at a future point undertake a broader review into the connections market. Through such a review, we might consider whether there remain any barriers that are obstructing efficient competition from developing and whether this is likely to cause consumer harm.

² The Electricity Act 1989, see [here](#)

³ See section 3 which explains the scope of this review.

⁴ We also note that the DNOs are still responsible for completing non-contestable connection activities in these market segments. We consider that existing licence arrangements ensure that DNOs deliver specified standards of performance for these customers (e.g. Standard Licence Condition 15). To ensure that DNOs are incentivised to deliver best practice in the provision of non-contestable activities, the Incentive on Connections Engagement or ('ICE') is currently in operation on a reputational basis in certain RMS.

2. Introduction

Section summary

In this section we discuss, at a high level, the arrangements for competition in the connections market, what steps we have taken to enable competition and why we are proposing to conduct this review.

Background

- 2.1. The regional electricity networks are natural monopolies. To protect consumer interests, we set controls around the revenue they are allowed to recover. Through this process, we also set service quality targets with associated financial incentives to reward companies who outperform targets and penalise those who do not deliver the expected level of service.
- 2.2. Although most DNO activities reflect their monopoly position, the provision of new connections is an area where competition has the potential to exist.
- 2.3. In making a connection there are some activities that must be undertaken by a DNO. These are referred to as non-contestable activities and include specifying the design, installation criteria and materials to be used for contestable work and the connection of contestable works to the distribution network other than at LV, among others.
- 2.4. However, there are some connection activities that can be undertaken by parties other than the DNO, such as Independent Connection Providers ('ICPs')⁵ and licensed Independent Distribution Network Operators ('IDNOs').⁶ The activities these parties can compete against the DNO to undertake are referred to as contestable activities. Contestable activities include the design of extension assets and procuring materials among others.

⁵ Independent Connections Providers complete and develop local electricity distribution networks but cannot operate or maintain them.

⁶ Independent Distribution Network Operators (IDNOs) complete, develop, operate, and maintain local electricity distribution networks. IDNO networks are directly connected to the Distribution Network Operator (DNO) networks or indirectly to the DNO via another IDNO.

2.5. The connections market consists of various segments⁷ which reflect the different types of customers and types of work. In practice, competitors are more likely to be drawn to those parts of the market where the work is of sufficient value to warrant the costs involved in entering the market. Those market segments where we consider competition is viable are referred to as Relevant Market Segments ('RMS'). The market segments where we do not consider competition to be presently viable, due to the relatively low value of the work, are referred to as Excluded Market Segments.

The steps we have taken to enable competition

2.6. Where competition exists, we believe it can be a more effective way of delivering improvements in customer service and efficiency. However, despite competition being possible by 2010 we had concerns that competitors were not able to successfully compete against DNOs across the different connection markets. Therefore, we introduced new tools and regulatory provisions to stimulate competition. For example:

- In 2010, as part of Distribution Price Control Review ('DPCR') 5⁸ we introduced a **regulated margin** of 4% that DNOs were required to charge connecting customers for contestable works in each RMS in their licence areas. This was to create a level of headroom in the price charged by DNOs against which new entrants might be more able to compete. Prior to this, DNOs were only permitted to recover from connecting customers their efficiently incurred costs. The regulated margin did not apply to any of the connections services in Excluded Market Segments.
- Between 2012-2014 we ran the DPCR5 **Competition Test** (the "Competition Test").⁹ Through this process we assessed the level of effective competition in each RMS in each licensee region. Where we saw evidence of effective competition - where the Competition Test was 'passed' - we permitted DNOs to charge an unregulated margin for contestable works. In those RMS that did not

⁷ In this consultation document we use the terms 'market' and 'markets' to refer to different segments of the energy sector. For the avoidance of doubt, these terms are not intended to describe or otherwise suggest the approach that may be taken by us for the purposes of market definition, for example in competition law investigations.

⁸ DPCR5 was a price control that ran from 1 April 2010 until 31 March 2015

⁹ See Appendix 1 for more detail and the outcomes of the DPCR5 Competition Test

pass the Competition Test, DNOs continued to charge a regulated margin of 4%. We did not assess the level of competition in Excluded Market Segments.¹⁰

- In 2015, we approved the **Competition in Connections Code of Practice** ('CiCCOP'). This imposed on DNOs a license requirement to comply with an industry-agreed set of standards concerning their interaction with competitive connection providers. These standards are intended to remove barriers to competition that may arise as a result of DNO processes.¹¹

RIIO-ED1 arrangements

- 2.7. In addition to the above, the outcome of the Competition Test informed the arrangements we put in place for the current price control (RIIO-ED1).¹²
- 2.8. In the RMS that did not pass the Competition Test, we applied price control incentives on the performance of DNOs in delivering connection services. In the absence of competition, these incentives were intended to drive DNOs to meet their connection customers' expectations. Through these incentives, DNOs are penalised if they fail to deliver an appropriate level of service to connection customers.
- 2.9. However, in the RMS that passed the Competition Test, we limited the application of price control incentives.¹³ Our view was that competitive pressure would ultimately drive DNOs to deliver a service in line with customer expectations, or risk losing market share. We also considered that price control-linked incentives on the level of service DNOs provide to connection customers might distort competition, as competitors to the DNO would not be subject to the same incentives.

¹⁰ Excluded Market Segments for this review are LVSSA and LVSSB. LVSSA connections are LV connection activities relating to no more than four domestic premises or one-off industrial and commercial work (i.e., one to four houses). LVSSB connections are connections activities in respect of a connection involving three-phase whole current metering at premises other than Domestic Premises. (i.e., one off LV connections).

¹¹ The CiCCOP governs the way in which DNOs provide input services to facilitate competition in the electricity connection distribution market.

¹² RIIO stands for Revenue = Incentives + Innovation + Outputs. The current RIIO-ED1 price control runs from 1 April 2015 to 31 March 2023.

¹³ Connections Guaranteed Standards of Performance and the Complaints Metric incentives apply to all RMS to protect connections customers from receiving unacceptably poor levels of service and to incentivise DNOs to respond to complaints efficiently.

Why we are undertaking this review

2.10. In establishing the arrangements for RIIO-ED2, we want to review the level of competition in certain parts of the market to determine if there have been changes since the completion of the Competition Test. Specifically, we are interested in the RMS where we had previously not seen evidence that effective competition existed.

2.11. There are two main reasons for undertaking this review:

- **There could be RMS that did not previously pass the Competition Test and in which we see no prospect of competition developing:**
 - Where this is the case, we may want to consider how we can best use price control incentives in RIIO-ED2 to ensure connection customers receive a high quality of service.
 - There may also be implications for the regulated margin that DNOs continue to charge customers for contestable services in these segments. This margin was introduced to provide headroom in this expectation that would support the development of competition. However, if the evidence suggests that effective competition has not developed to date, and may be unlikely to do so in the future, then we may want to review the application of this regulated margin or its value.
- **There could be RMS that did not previously pass the Competition Test, but where there is now effective competition:**
 - In RIIO-ED1, DNO performance in the RMS are subject to price control incentives. For RIIO-ED2, it may be appropriate to consider whether to apply incentives on performance, in particular, on the delivery of contestable services, to avoid the risk that our regulation might distort competition.
 - In these RMS, it may also be appropriate to remove the 4% regulated margin and allow DNOs to charge an unregulated margin.

What are we consulting on?

2.12. In this policy consultation we seek views on our proposed approach to reviewing competition, specifically:

- the proposed scope of our review;
- the steps we will follow to assess the level of competition in the licensee's RMS; and
- the information we will collect and use to inform the assessment.

Next steps

2.13. On review of the responses, we will publish our decision on whether to undertake this review and on its scope, should we choose to proceed.

2.14. If we decide to proceed with a review of competition in the electricity connections market, we will issue, alongside the decision, an invitation to DNOs to complete the data template for our review.

How to respond

2.15. We have set out specific questions in Sections 3, 4 and 5 of this document, which we encourage stakeholders to submit responses to.

2.16. Additionally, as part of this consultation, we are seeking views on our data template, which aims to consolidate and standardise the information we will collect from DNOs and has been published alongside this consultation.

2.17. We invite comments from stakeholders on our proposal to review the level of competition in the connections market as set out in this document. **Please provide responses by 13 August 2021** and send your responses to RIIOED2@ofgem.gov.uk. We look forward to hearing from you.

2.18. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

- 2.19. You can ask us to keep your response, or parts of your response, confidential. We will respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.
- 2.20. If you wish to respond confidentially, we will keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We will not link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

3. The proposed scope of the review

Section summary

This section provides an overview as to what is both included and excluded as a part of the proposed scope of this review.

What is in the proposed scope?

3.1. This review of competition will be focused on the nine RMS that were established in 2010, where we considered competition in connections was viable. We consider that for the purpose of evaluating the level of effective competition in the market, the RMS remain appropriate as a means of distinguishing between different types of connections work and customer type. We welcome views on whether there are alternative classifications for the connections market that should apply.

3.2. The RMS are described in the table below:

Table 1: Relevant Market Segments

Relevant Market Segments	
Metered Demand Connections	Low Voltage (LV) Work - LV connection activities involving only LV work, other than in respect of the Excluded Market Segments.
	High Voltage (HV) Work: LV or HV connection activities involving HV work (including where that work is required in respect of connection activities within an Excluded Market Segment).
	HV and Extra High Voltage (EHV) Work: LV or HV connection activities involving EHV work.
	EHV work and above: extra high voltage and 132kV connection activities.
Metered Distributed Generation (DG)	LV work: low voltage connection activities involving only low voltage work.
	HV and EHV work: any connection activities involving work at HV or above.

Relevant Market Segments	
Unmetered Connections	Local Authority (LA) work: new connection activities in respect of LA premises.
	Private finance initiatives (PFI) Work: new connection activities under PFIs.
	Other work: all other non-LA and non-PFI unmetered connections work.

3.3. On the basis that these RMS remain appropriate, we propose to concentrate this review on those RMS that did not previously pass the Competition Test in each DNO’s licence area.

3.4. This review of competition will assess certain key indicators for competition in each RMS over the last three years. These indicators will account for specific dimensions of the connections market and include: the volumes of connection offers / acceptances, the number of competitive alternatives and the size of the connections in MW.¹⁴ These indicators are largely consistent with data that informed the Competition Test.

What is excluded from the proposed scope?

Excluded Market Segments

3.5. We do not propose to consider the level of effective competition in Excluded Market Segments through this review. We have not seen any evidence that competitors are likely to be attracted to work in these segments. Therefore, we do not consider that consumers in these segments would be likely to benefit from changes to the current arrangements – such as the restrictions that only allow DNOs to recover their efficient costs for connection works – that might accompany us opening these markets out to competition.

RMS that previously passed the Competition Test

¹⁴ See Section 5 for more details on the assessment framework and the types of indicators we will be taking into consideration in our review.

- 3.6. We also do not propose to consider the level of effective competition in those RMS that previously passed the Competition Test. Since the Competition Test concluded, we have put in place a number of arrangements to address barriers to competition that might otherwise exist. Of particular relevance is the licence condition (SLC52) that requires DNOs to comply with – and report their compliance against – the CiCCOP.
- 3.7. Therefore, in those RMS that previously passed the Competition Test and where there has been no evidence of non-compliance with the CiCCOP, we consider that conditions for effective competition exist; we have previously seen evidence of effective competition and assume that this is likely to have been maintained, or, if the level of third party activity has subsequently declined, we consider that there are no barriers that would prevent it from subsequently returning to previous levels.
- 3.8. On this basis we consider that the current arrangements remain appropriate. In light of finite resources, we are therefore focussing on those RMS that did not previously pass the Competition Test.

DNO behaviour & processes and customer awareness

- 3.9. As part of the Competition Test, we also considered other factors that could influence the level of effective competition. These included the extent to which DNO behaviour, processes and services were facilitating or operating as a barrier to competition. We also considered whether customer awareness and willingness to use competitors could be a reason for varying levels of competition in different parts of the market.
- 3.10. Our assessment of these factors helped us to identify remedies to address potential barriers to competition. As described above, these included the licence requirement to comply with the CiCCOP.
- 3.11. We may choose to consider the effectiveness of these remedies, however at this time this is not the focus of this review. Through this review, we are looking for evidence that effective competition exists in order to inform the design of RIIO-ED2, rather than establishing an understanding of the factors that may be restricting the development of competition.

Consultation questions

Table 2: Section 3 consultation questions

Section 3 questions	
Q1	Do you agree that the current classification of RMS remains appropriate as a means of distinguishing between different types of connections work and customer type? If you disagree, please provide your views on which alternative classifications should apply
Q2	Do you agree with our proposal not to consider the level of effective competition in the Excluded Market Segments? Please provide reasons for your views.
Q3	Do you agree with our proposal not to consider the level of effective competition in the RMS that previously passed the Competition Test? Please provide reasons for your views. Please also provide any information or evidence that you have, which may suggest that competitive conditions have materially changed (in particular, if such changes have not been positive) in these RMS since we conducted the Competition Test.
Q4	Do you agree with our proposal to assess whether effective competition exists by only considering the key indicators for competition set out in Section 5? Please state why if you disagree, and consider that there are other factors we should take into account, such as DNO behaviour, processes and customer awareness.

4. Possible outcomes from our review of competition

Section summary

This section discusses what we think the three possible outcomes of this review could be, with targeted questions requesting stakeholder views towards the end.

- 4.1. Based on the scope described above and the assessment criteria discussed in Section 5, we consider there to be three possible outcomes from this review of competition:

An RMS does not pass the competition review, but we consider there to be a prospect of competition developing

- 4.2. Under this outcome, our indicators would demonstrate that third parties are competing with DNOs for connections work or have the potential to do so. However, at this time we are not satisfied that the level of competition is sufficient to effectively protect consumer interests. Therefore, the RMS will not 'pass' the competition review.
- 4.3. Where this is the case, we may consider whether or not to apply price control-linked incentives on connection services performance in RIIO-ED2 (eg the Major Connections Strategy Delivery ODI).¹⁵ Our consideration will take into account the extent to which these incentives could potentially distort the development of competition. Ensuring DNOs deliver adequate service may require exposing DNOs to the threat of a penalty if they are unable to meet the expected standard of service. However, rewarding DNOs that exceed these levels (for contestable services) may distort competition in the market, as their competitors would not receive similar financial rewards.
- 4.4. In addition, we may also choose to retain the application of a regulated margin on top of the cost of work to continue to provide headroom for competition to develop. Although this results in an additional cost for consumers, we might consider that

¹⁵ The Strategy Delivery ODI will hold DNOs to account for the delivery of their major connections strategies, through an ex post evaluation, in the form of a financial output delivery incentive.

removing the regulated margin in these RMS might stifle the potential for competition to develop. This may not be in the best interests of current and future consumers.

An RMS does not pass the competition review and we consider there to be no prospect of competition developing

- 4.5. If we consider that there is no prospect of competition developing, based on little-to-no evidence of effective competition, the RMS will not pass the competition review.
- 4.6. Indicators of this would be a very small number of, or no, third parties competing or winning any connections work. We may also consider whether there is sufficient evidence that effective competition exists in this RMS elsewhere in Great Britain, that might indicate a plausible likelihood of it subsequently developing.
- 4.7. In the absence of sufficient competitive pressure to deliver benefits to consumers, we may choose to use price control-linked incentives in RIIO-ED2 to improve the level of connection services DNOs provide. In these market segments, the application of incentives may be unlikely to distort competition. We may therefore choose to apply a combination of penalties to ensure an adequate level of service is provided, and rewards to drive DNOs to continually improve their service offering.
- 4.8. In these market segments, we may also consider whether the ability for DNOs to recover a regulated margin is in the interests of consumers, as the additional cost of doing so may not be enabling the development of competition.

An RMS passes the competition review

- 4.9. Where we see evidence of effective competition, the RMS will pass the competition review. The indicators would illustrate that third parties are effectively competing for connections work both in terms of numbers of offers / acceptances and level of capacity completed.
- 4.10. Where this is the case, we are likely to limit the application of price control linked incentives in RIIO-ED2, in particular those that might apply to contestable services. This is because we consider the presence of competitive pressure to be sufficient to ensure customer receive high-quality connection services, and that competition could be distorted by us exposing DNOs to financial incentives that their competitors do not face.

4.11. We may also consider that the regulated margin should be removed, and DNOs permitted to charge an unregulated margin in the expectation that competitive pressure should drive this down to an efficient level.

4.12. The table below summarises the potential outcomes of the competition review and the relevant incentives that would or would not apply:

Table 3: Summary of the impact of the proposed competition review on RIIO-ED2 output and incentive arrangements

Incentive/Measure	Excluded Market Segments	An RMS passes the competition review		An RMS does not pass the competition review, but we consider there to be a prospect of competition developing	An RMS does not pass the competition review and we consider there to be no prospect of competition developing
		Contestable	Non-contestable		
4% Regulated Margin	Not apply	Not apply	Not apply	Apply	Not apply
Guaranteed Standards of Performance (GSoP)	Apply	Apply	Apply	Apply	Apply
Time to Connect incentive	Apply	Not apply	Not apply	Not apply	Not apply
Customer Satisfaction Survey	Apply	Not apply	Not apply	Not apply	Not apply
Complaints Metric	Apply	Apply	Apply	Apply	Apply
Strategy Delivery ODI	Not apply	Not apply	Apply	Apply	Apply

Consultation questions

Table 4: Section 4 consultation questions

Section 4 questions	
For an RMS that does not pass the competition review, but we consider there to be a prospect of competition developing;	
Q5	Do you think we should apply price control incentives on DNO performance? If so, should these be only penalties on poor performance, or should we consider rewarding DNOs that provide a higher quality of service? Please state what impact you consider this might have on competition.
Q6	Should we maintain the regulated margin? If you think it should be maintained, please explain why and whether you consider there should be a change in the 4% level of margin that is currently applied.
For an RMS that does not pass the competition review, and we consider there to be no prospect of competition developing;	
Q7	Do you think we should apply price control incentives on DNO performance? If so, should these just be penalties on poor performance, or should we consider rewarding DNOs that provide a higher quality of service? Please state what impact you consider this might have on competition.
Q8	Should we remove the regulated margin? If you think it should be maintained, please explain why and whether you consider there should be a change in the 4% level of margin that is currently applied.
For an RMS that passes the competition review;	
Q9	Should we limit the application of price control incentives? If you think we should apply price control incentives, please explain why and what type of incentives would be appropriate.
Q10	Should we permit DNOs to charge an unregulated margin? If you think the regulated margin should be maintained, please explain why and whether you consider there should be a change in the 4% level of margin that is currently applied.

5. Proposed approach to reviewing competition

Section summary

In this section we discuss our proposed approach for the competition review, focusing on: what information we propose to consider and analyse, how this will help us understand the level of competition in RMS, the assumptions we would employ and limitations of the proposed approach.

High level overview

- 5.1. To undertake this review of competition, we have prepared a data template which we would request DNOs to complete for RMS that did not pass the Competition Test. We propose to carry out our assessment as follows:
- Firstly, we would carry out the mandatory Legal Requirements Test, which assesses the DNO's compliance with relevant connections related licence conditions and the Competition Act in the relevant regulatory year.¹⁶ Passing the Legal Requirements Test is a pre-requisite to the competition review.
 - Following this, we would carry out the competition review which will investigate data of key market indicators between the regulatory years 2017/18 to 2019/20 to assess the level of competition between DNOs and third parties across RMS.
- 5.2. In undertaking this analysis, we would be relying predominantly on information provided by the DNOs, through the data template. However, in instances where we require more information to form our decision, we could ask supplementary questions or revisit the Competition Test data to understand longer-term trends.
- 5.3. We would be collecting the same type of data across all the DNOs' RMS and relying on a common set of market indicators to inform our analysis. We would also be reviewing

¹⁶ The Legal Requirements Test is defined in the electricity distribution licence Charge Restriction Conditions (CRC), for each licensee, under CRC 2K.

each RMS independently from each other as, while our analysis would be informed by the same guiding principles across all RMS, the conclusions we will be able to draw from our assessment may vary from one region to another.

Assessment approach

The Legal Requirements Test

5.4. As defined in CRC 2K of the Special Conditions Licence, the Legal Requirements Test means an assessment of the licensee's compliance, in respect of the making of connections to its Distribution System, with:

- paragraph 12.6 (c) of standard condition 12 (Requirement to offer terms for connection within 65 working days);
- standard condition 15 (Standards for the provision of Non-Contestable Connection Services – Guaranteed Standards);
- standard condition 15A (Connections policy and connection performance, e.g. quotation accuracy);
- standard condition 19 (Prohibition of discrimination under Sections 4 and 5); and
- the Competition Act 1998.

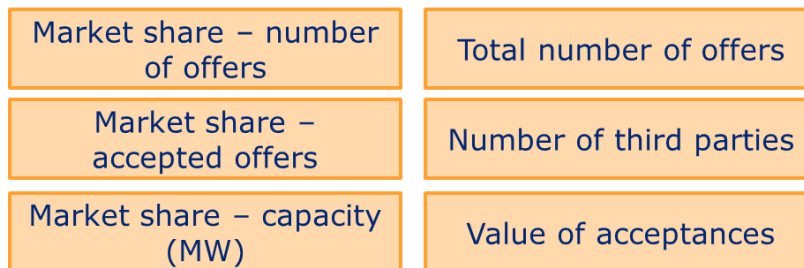
5.5. A DNO's RMS passes the Legal Requirements Test if it had no enforced breaches of the relevant connections related licence conditions and the Competition Act 1998 in the relevant regulatory year, and is required to satisfy the Legal Requirements Test for all of its DSAs. We would ask DNOs to provide this information, through the data template, by indicating whether it complies with all the conditions of the Legal Requirements Test stated above.

5.6. Passing the Legal Requirements Test is a pre-requisite to the competition review. Failure of the Legal Requirements Test means we will not be able to progress with our review of key market indicators to assess competition.

Review of competition

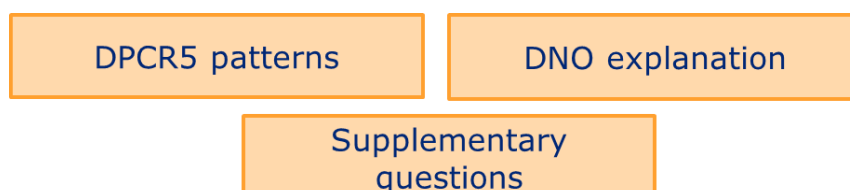
- 5.7. If DNOs meet the Legal Requirements Test, we will progress towards assessing the level of competition in the DNO’s DSA for the RMS that did not pass the Competition Test.
- 5.8. We propose to analyse a set of indicators on the state of the connections market using a flexible assessment framework. This should not be seen as a set of fixed rules that would automatically determine whether the level of competition in an RMS is sufficient to lift price regulation or not. Rather, it should be viewed as guiding principles and assessment dimensions, that would jointly create a picture of the market dynamics in each RMS. We will then use this to inform our decisions on the regulated margin in each RMS, reflecting the specifics of each market segment.
- 5.9. For each RMS, we propose to assess the following key market indicators:

Figure 1: Key market indicators for the assessment



- 5.10. While no single variable can by itself give certainty over the level of competition in an RMS, we consider that a joint assessment of the proposed market indicators can generate enough insight to draw conclusions on whether effective competition exist.
- 5.11. In cases where evidence from the key market indicators is not sufficient or does not allow us to draw any robust conclusions, we propose to rely on additional evidence to inform our review. Additional evidence includes:

Figure 2: Additional evidence



5.12. The purpose of this additional evidence is to complement the insight that can be drawn from the key market indicators; trying to add context and potentially explain the rationale behind the trends and observations, rather than to drive the assessment of competition by itself.

5.13. We define and describe the purpose of each key market indicator and additional evidence in turn below.

Market shares

5.14. The level of market shares reflects the amount of activity undertaken in each RMS by the DNO and by the totality of third parties, showing how contestable work is split amongst the two types of market participants.

5.15. The level of the market share of the DNO in an RMS will inform the amount of the market covered by the DNO at a point in time. The trend over time will inform whether the role of third parties in the RMS has expanded and, as a result, whether the role of the DNO has shrunk.

5.16. We propose to examine three different types of market shares that will help give a comprehensive representation of the split between DNO and third parties. In particular:

- Shares based on the **number of offers** will proxy the relevance of DNOs and third parties in the activity of the market.
- Shares based on **accepted offers** will proxy the relevance of DNOs and third parties in work that was carried out.
- Shares based on the **total capacity** of the work can inform on the type and size of jobs (eg different levels of capacity) that DNOs and third parties are completing.

Number of third parties, total number of offers and the value of acceptances

5.17. We consider evidence on the **number of third parties**, both issuing quotes and completing work, important because it gives us an indication on how many competitors there are active in a given RMS. The same level of DNO market shares can imply very

different levels of competition in an RMS depending on how many third parties compete against the DNO.

- 5.18. The total number of DNO and third party connections would complement the insight from market shares and number of third parties. Its evolution can inform the total size of the market and can highlight market growth as a whole and how that is split between DNOs and third parties.
- 5.19. **The value of acceptances** refers to the monetary value of full, partial, and non-accepted for contestable and non-contestable connection work by the DNO. This information allows us to understand what the average value of work in different RMS is, and how this has changed over time. It can be seen as a complementary measure to the size of the market, in monetary terms.

Additional information

- 5.20. There might be instances where the assessment of market shares, number of third parties and market growth for specific RMS are not sufficient to inform our assessment of the level of effective competition. In such instances, we propose to expand our assessment by:
- considering the market trends and data patterns from the DPCR5 review;
 - analysing the DNO's explanation and supporting qualitative evidence; and/or
 - asking targeted supplementary questions where additional evidence or clarity is needed to complete our assessment.
- 5.21. The comparison of the 2017/18-2019/20 market outcomes (eg market shares, number of third parties) with those at DPCR5 can help understanding whether the level of competition has increased or decreased since then. We anticipate that this comparison would only be applied to selected cases and be limited to the information that is readily available from the DPCR5 review.
- 5.22. In the data template, we have included a comment box where DNOs are encouraged to provide an explanation on the rationale behind any patterns in the submitted data. This could be explaining why, for example, third parties may be increasing or decreasing in a specific RMS.

5.23. If even after assessing all these variables, we consider that there is still not enough evidence to conclude our assessment for a specific RMS, we would consider issuing supplementary questions. In these, we would ask for further data or evidence to explain specific issues or trends in the existing data.

Limitations

5.24. While the proposed data template allows us to capture evidence on the activities carried out by both DNOs and third parties as a whole¹⁷, it does not provide a disaggregation for each type of third party given that only DNOs would be requested to complete the data template.

5.25. We consider this level of granularity sufficient given the scope of this review. However, the high-level information on third parties poses practical limitations, in that we cannot calculate the market share of each third party within an RMS and hence would not be able to assess how each third party competes against the DNO. Rather, we will rely on the split between DNOs and the totality of third parties and use it as a proxy.

Content of the data template

5.26. The data template, which we would request DNOs to complete, will serve as the primary source of information for reviewing the levels of competition in RMS.¹⁸

5.27. It contains information on key market indicators between 2017/18 - 2019/20 for activity carried out by DNOs and third parties. As DNOs offer the point of connection ('POC') for all connections, they would have access to data on third party connection offers; therefore, we expect DNOs to capture the third party data as well.

5.28. We propose to analyse the last three regulatory years of data (2017/18, 2018/19 and 2019/20) of the connections market. We believe this period will provide a reasonable sample for the assessment of competition. We are interested in views on whether we should also consider data for 2020/21, although we are mindful that the impact of

¹⁷ As the DNO offers the point of connection (POC) for all connections, it has data on third party connection offers.

¹⁸ We are not reviewing DSAs generically, rather RMS within a DSA.

Covid-19 may make data for this period unrepresentative of underlying trends in competition.

5.29. We are requesting both contestable and non-contestable data from DNOs. However, the key figures we would be taking into consideration in our final analysis would be the contestable figures, as third parties do not undertake non-contestable activities. The proposed data template is a Microsoft Excel workbook with the following structure:

Table 5: Structure of the proposed data template

Sheet name	Sheet content
Guidance sheet	High-level description of the content of the workbook
1. Legal Requirements Test	Legal compliance declaration from DNOs
2. Quotations Issued 2017-18	<ul style="list-style-type: none"> Information for 2017-2018 on number of offers, acceptances, capacity, total value of acceptances for each RMS. Information is split by DNO and third parties for each RMS and includes both contestable and non-contestable work.
3. Quotations Issued 2018-19	<ul style="list-style-type: none"> Information for 2017-2018 on number of offers, acceptances, capacity, total value of acceptances for each RMS. Information is split by DNO and third parties for each RMS and includes both contestable and non-contestable work.
4. Quotations Issued 2019-20	<ul style="list-style-type: none"> Information for 2017-2018 on number of offers, acceptances, capacity, total value of acceptances for each RMS. Information is split by DNO and third parties for each RMS and includes both contestable and non-contestable work.
5. Sub Category Summary	<ul style="list-style-type: none"> Outcome of DPCR5 competition test process for different market segments subcategory. Computation of market shares
6. Full Market Segment Summary	<ul style="list-style-type: none"> Outcome of DPCR5 competition test process for different market segments. Computation of market shares
7. Summary – Three Year Trends	<ul style="list-style-type: none"> Trends of market shares across over time.

Sheet name	Sheet content
	<ul style="list-style-type: none"> Information on the number of competitive alternatives across years.

Consultation questions

Table 6: Section 5 consultation questions

Section 5 questions	
Q11	Do you agree that our assessment criteria successfully captures the key market indicators that would inform us of whether third party presence has expanded or decreased over time? If not, please specify if there is other information we should consider, in determining whether effective competition exists and why.
Q12	Should we consider data from the 2020/21 regulatory year or given the impact of the Covid-19 pandemic, would this not be a reliable indication of the underlying levels of competition?
Q13	What are your views on the structure of the data template we are proposing to use to carry out our analysis?

6. Appendix

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Appendix 1 – The DPCR5 Competition Test

- 6.1. In 2012, we ran the DPCR5 Competition Test to understand the extent to which competition existed in the market for new connections. DNOs were able to apply to us to have price regulation lifted if they could demonstrate that competition was sufficiently effective to constrain prices in its absence.
- 6.2. On assessing the level of competition in the connections market, we removed price regulation for several market segments.
- 6.3. At the end of the process, we concluded that, across the 14 DNO Distribution Service Areas ('DSAs'), effective competition existed in, and therefore removed price regulation for 42 of the 126 RMS.
- 6.4. For market segments that failed the competition test, we mandated that DNOs charge a 4% regulated margin on top of the cost of the work to provide headroom for competition. For market segments that passed, DNOs would earn an unregulated margin.
- 6.5. The results of the 2012 review informed our approach to setting outputs and incentives for RIIO-ED1. We did not apply incentives for market segments where there is active competition. We applied penalty-only schemes where there is potential for competition to develop. We applied a wider range of reward and penalty mechanisms where there is no competition.
- 6.6. See the table below that illustrates the outcomes from the DPCR5 Competition Test:

	ENWL	NPg		UKPN			WPD				SSE		SPEN	
RMS		NPgY	NPgN	EPN	SPN	LPN	EMID	WMID	SWEST	SWALES	SHEPD	SEPD	SPD	SPM
Metered demand LV	Pass	Did not apply	Did not apply	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass
Metered demand HV	Pass	Pass	Pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Pass	Did not pass
Metered demand HV & EV	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Pass	Pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass
Metered demand EV and above	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Pass	Pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass
Distributed generation LV	Did not pass	Did not apply	Did not apply	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass
Distributed generation HV and EV	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Did not pass	Did not pass	Pass	Did not pass	Did not pass	Pass	Did not pass	Did not pass
Unmetered local authority	Pass	Did not pass	Did not pass	Pass	Pass	Did not pass	Pass	Pass	Pass	Pass	Did not pass	Did not pass	Did not pass	Pass
Unmetered PFI	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Pass	Pass	Pass	Pass	Did not pass	Pass	Did not pass	Pass
Unmetered other	Did not pass	Did not apply	Did not apply	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass

Key	
Pass	Pass
Did not pass	Did not pass
Did not apply	Did not apply