

James Veaney
RIIO-ED2 Project Director
Ofgem,
10 South Colonnade,
Canary Wharf,
London E14 4PU

13 August 2021

Dear James,

SSE Distribution response to Ofgem’s consultation on reviewing competition in the electricity connections market for RIIO-ED2

On behalf of Scottish Hydro Electric Power Distribution plc and Southern Electric Power Distribution plc, we welcome the opportunity to respond to the Ofgem’s proposal to review competition in the electricity distribution connections market for RIIO-ED2.

We are supportive of the review of competition in electricity distribution connections in RIIO-ED2. The industry has moved forward significantly since the competition test was run in 2013; competition is more extensive, and customers have more options. Therefore, the framework should be updated, and this should be reflected in the design of any incentives for RIIO-ED2. It is imperative any incentive based on the results of a competition test should be based on an update from the 2013 findings.

It is also worth noting that reviewing effective competition at the beginning or during the RIIO ED2 period rather than now could cause a host of aspects needing to be revisited and realigned. This would also have an impact on which Relevant Market Segments (RMS) are included in the proposed Strategy Delivery Incentive (SDI). Therefore, the review and results should be prioritised and finalised before RIIO ED2 Final Determination.

With the above in mind, we have responded to each of Ofgem’s consultation questions in the remainder of this letter.

Yours sincerely,

Clothilde Cantegreil

Head of Regulatory Strategy (RIIO-ED2)

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

We agree that the current classification of RMS remains appropriate to distinguish between different types of connections work and customer type.

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.

We agree with this proposal as there is currently limited evidence that alternative providers have interest in carrying out works in the Minor Connections market segments. However, these market segments will be included in any further discussions/engagement with ICPs and IDNOs on increasing levels of effective competition.

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.

SSEN agree there is not a need to consider the level of effective competition in the RMS which previously passed the Competition Test in 2013. This is covered by an existing Special Licence Condition.

In line with the requirements of Special Licence Condition CRC 2K, DNOs currently submit their Competition Notice Annual Update by 30th June each year for the RMS which passed the competition test back in 2013. Within this, we report on the Legal Test and Competition Test, the Market Data for the RMS which passed the competition test, and the improvements, opportunities and initiatives we have implemented relating to these RMS.

Our Competition Notice Annual Update report highlights changes of particular aspects, related to the review of effective competition, including alternative provider activity, market value and market volume and compare these to the values at the time of the 2013 Competition Test. As such, we see this information is adequate to demonstrate how competition has changed, whether positive or negative, without the need to revisit these RMS in the re-run of the competition test.

Our reports to date have not highlighted any material negative changes in the RMS which passed the Competition Test in 2013.

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

Yes, we agree with the proposal to assess whether effective competition exists based on the proposed key indicators for competition. These indicators match those we have discussed in working groups with other DNOs, other stakeholders and Ofgem in the run up to this consultation.

However, we need to be careful when evaluating the total number of offers in a market segment with the ability to convert all works offers to non-contestable only acceptances.

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.

Applying a price control incentive on DNOs' performance is dependent on the intended policy outcome of the incentives which are still to be bottomed out by Ofgem for RII0-ED2. The incentive should be based on objective criteria and quantifiable metrics, to the extent these are available.

SSEN's preference would be a symmetric approach to rewards and penalties. We do not think that a penalty only mechanism would be appropriate given the nature of connections and the changing landscape.

Furthermore, the outcome of the competition test would differ from one DNO to the next, making comparison across DNOs difficult and therefore, it would be more effective for any incentive to focus on each DNO's performance against their own strategy.

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.

Yes, regulated margins maintain a fair and competitive level playing field in each segment that does not pass the competition review.

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.

Our view on this is very similar to the previous points highlighted in our response to Q5 above: it is dependent on the intended policy outcomes of an incentive. However, an incentive would provide protection for customers in segments where there is no prospect of competition developing as it will further drive the right behaviours in DNOs to provide a good level of service.

Again, SSEN's preference would be a symmetric approach on rewards and penalties as we do not think that a penalty only mechanism would be appropriate given the nature of connections and the ever-changing environment.

RMS which pass the competition test are protected by the competitive market place and RMS which do not pass but hold prospect of competition developing would be protected by the Strategy Delivery Incentive.

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.

We believe that the 4% margin should be maintained where there are insufficient levels of competition at present. Changing the regulated margin to 0% could deter competition from developing as lower margins could be a barrier for third parties due to reduced DNO prices. This could be appropriate when there is absolutely no competition present or likely to develop in a market segment, but this is currently not the case in any of our RMS.

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.

An RMS which passes the competition review should not be captured in a price control incentive. In these segments where competition is prevalent, customers are protected by legal requirements such as the Legal Requirements Test and Competition Test and the pressures of a competitive market which ensure DNOs are incentivised to improve service levels.

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

DNOs should continue to be permitted to charge unregulated margins for RMS that pass the competition review and are operating in a free market as the competitive market will drive the price.

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.

Yes, we believe it does. The volume of market participants, offers, acceptances, capacity levels and in some cases project values together provide a reasonable view from which to assess competition.

Consideration of competition in the Unmetered market segments needs to be viewed based on number of unmetered tasks completed in the period (i.e., new connections, transfers and disconnections), rather than number of applications. Unmetered projects can vary in size from one to over 3,000 unmetered tasks in a 12-month period. This is due to ICPs applying for a Network Access Agreement and Unmetered Connection Adoption Agreement per Unmetered Customer, for a 12-month period, to carry out unlimited unmetered connections in that 12-month period for their specific Customer. Almost all unmetered works in the Private Finance Initiative (PFI) sector alone are now carried out by Alternative Providers (98% in 2019-20 and 2020-21 reporting periods) in SEPD's Distribution Service Area (DSA).

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?

We would not oppose to providing 2020/21 Covid-19 year data for completeness and Ofgem's assessment. We would, however, encourage Ofgem to request data for the 3 years previous to 2020/21, and the 2020/21 data – a total of 4 years. This would avoid distortion in the assessment of competition if Covid trends are so obviously different to previous years' results.

In some instances, Covid year data may not reflect a true picture of competition compared to previous years and that needs to be taken into account during the review of competition. We would encourage Ofgem to use Covid data to help secure more confidence of competition in RMS but be conscious of large negative trends from previous years and exclude these from the assessment.

Q13 What are your views on the structure of the data template we are proposing to use to carry out our analysis?

The proposed structure of the data template is appropriate. We have identified that some of the formulas may need to be reviewed and adjusted and we would suggest going through this in a working group environment.