

James Veaney
Head of RIIO2 Policy
Systems & Networks
10 South Colonnade
Canary Wharf
London
E14 4PU

Electricity North West
Frederick Road,
Salford, M6 6QH

Email: enquiries@enwl.co.uk
Web: www.enwl.co.uk

Direct line: 07795 447817
Email: Brian.Hoy@enwl.co.uk

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Sent by email only to: RIIOED2@ofgem.gov.uk

Dear James

Review of competition in the electricity distribution connections market

Whilst the potential impact for Electricity North West is less than other DNOs, due to us having passed all but two of the Relevant Market Segments (RMS), we support the intention of the review to provide a more contemporary view of the extent of effective competition for the purposes of setting price control incentives for RIIO-ED2. We have responded to the specific questions in the attached annex.

From a process perspective, it is disappointing that the outcome of the review will not be concluded before DNOs are required to submit Final Business Plans on 1 December 2021. Clarity on what assumptions DNOs should make is therefore needed in the Business Plan Guidance, eg assume the 2013 assessment position. In publishing its decision on this review, it is vital that Ofgem provides clarity on the outcomes for any assessment it undertakes. Specifically, there needs to be clarity on what price control incentives will apply to each of the three scenarios outlined in the consultation. It would be unreasonable for DNOs to have to decide whether to apply for an RMS to be reviewed if the consequences are unclear. Ofgem should also clarify the treatment of an RMS that did not previously pass the Competition Tests, should the DNO not submit a review as part of this proposed process.

Whilst we agree that RMS that previously passed the Competition Tests are excluded from the review, we were surprised that Ofgem does not intend to ask for the data for those market segments. We would have thought this would have been useful context to help its assessment.

If there are any points in our response you would like to discuss further, please let me know.

Yours sincerely

Brian Hoy
Head of Market Regulation and Compliance



Annex

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 remains appropriate to distinguish between the different types of connections work. It has been in place for some time and is the basis of other reporting to Ofgem and therefore allows comparability.

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 it is appropriate to not consider competition in the Excluded Market Segments. We do see some competition in these segments but not enough to consider it appropriate to be reviewed.

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.*

We agree with your proposal not to consider RMS that previously passed the Competition Tests.

In accordance with our Licence (Charge Restriction Condition 2K, paragraphs 17 and 18), we are required to submit an annual report to Ofgem. The scope of this report requires us to report on how change has occurred in the RMS and therefore this mechanism already exists.

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.*

We agree that the using the key indicators outlined is an appropriate way to assess competition. It should give a good and comparable way to see how competition has developed, requiring a proportionate amount of time for DNOs, Ofgem and other stakeholders. Other factors, as described, will influence the observed levels of competition. These may be relevant for a wider review of competition as referenced in paragraph 1.8 of the consultation.

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.*

We accept that it is reasonable for Ofgem to apply price control incentives in this situation. We think that, consistent with RIIO-ED1, these should be penalty only based on poor performance.

We do not support incentive rewards in this situation. We believe that it could cause a market distortion if DNOs had access to financial rewards that were not available to its competitors, particularly in this scenario where competition is not yet well established.

In addition, we believe that a regime with rewards available would be inequitable and effectively punitive to DNOs that have actively supported Ofgem's policy of competition in connections. Creating a situation where a DNO is better off in RIIO-ED2 by having not passed the Competition Tests in 2013, compared to one that did, creates a perverse incentive regime.

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.*

As outlined in paragraph 2.6 in the consultation, the purpose of the regulated margin was to create a level of headroom against which third parties could compete. In this scenario, where there is some competition but not fully effective, it would seem logical to maintain the regulated margin and to retain it at 4%.

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.*

We accept that it is reasonable for Ofgem to apply price control incentives in this situation. In this scenario, we consider that rewards for higher quality of service could be appropriate. If rewards were to be available for any RMS, then the wider context would need consideration. Rewards may be reasonable for one RMS where competition was not evident if there is sufficient evidence of competition across the other RMSs. This would assure Ofgem that the lack of competition was not down to other factors, such as the DNO's behaviour or processes. Similarly, if there was no apparent competition in an RMS in one DNO but was in other DNOs, then the reason for that difference would need to be understood by Ofgem before rewards were available. If there was no evidence of competition across any DNO then the treatment of that RMS for all DNOs could be changed.

Clarity on the criteria for rewards would be needed as part of Ofgem's decision on this consultation.

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.*

If there is no prospect of competition developing, then it would be appropriate to remove the regulated margin and reduce the cost to customers.

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.*

The price control incentives should be the same as those applied to the RMS that passed the Competition Tests in 2013.

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.*

The DNO should be allowed to charge an unregulated margin, consistent with those RMS that passed the Competition Tests in 2013.

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.*

We agree that generally, the assessment criteria captures the key market indicators. There are two areas where some caution would be advised.

The first relates to quotations issued. The concept of 'convertible' connection offers was developed a number of years ago and became a requirement of the Competition in Connections Code of Practice in 2015. These were designed to allow the customer to accept the full works offer for the DNO to carry out the work or to accept the point of connection only and then appoint an ICP to carry out the contestable work, all without the need for another application. Despite being designed with the customer in mind to support competition in connections, we do get ICPs applying for 'convertible' connection offers. We believe that we are obliged to provide this offer and therefore are effectively giving our charges for the job to our competitor who we believe will have no intention of ever accepting the full works offer. This is something we would like to further discuss with Ofgem. Despite these offers being made to a third party, they will be counted as a DNO connection offer and therefore will overstate the number of DNO connection offers.

The second relates to the value of acceptances. The value of acceptances is not comparable between those accepted by the DNO and those accepted by a third party. The DNO accepted connection offers will include both the contestable and non-contestable work; the third party work will only include the non-contestable work and therefore will typically appear to be lower in value.

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 think that it would be sensible for Ofgem to request the most contemporary information available and therefore include the 2020/21 regulatory year within the template. Commentary can be provided by the DNO if necessary and then Ofgem can make an informed decision as to how it is considered in its assessment rather than excluding it unilaterally.

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

Column C in Tab 5, column B in Tab 6 and column B in Tab 7 are to indicate the outcome of the Competition Test for each RMS. Since only RMS that did not pass will be submitted, we are unclear why this option is included.

Outcome of the DPCR5 Competition Test process - Pass, Did not pass or Did not apply
Please indicate the outcome of the DPCR5 Competition Test process