



Proposed connections competition review

KEY POINTS

- We can see the need for Ofgem to undertake a review of connections competition to inform whether or not price control incentives will be retained at ED2.
- Limiting the scope to this objective would miss a strategic opportunity to check how well the wider connections market is serving energy consumers and connectees, including the new electricity distributor (IDNO) based model of competition.
- With more than a million energy customers now connected to IDNO networks it is essential that Ofgem review whether:
 - the relative price control first put in place well over a decade ago is still appropriate; and
 - the uneven playing field currently in place in terms of tariff support for connection charges is harming the generality of energy consumers.
- The existing relevant market segments (RMS) do not capture all of the distinctions that matter for competitive dynamics. In particular:
 - We see distinctions within housing and small commercial developments at low voltage, depending on the number of end connections being made.
 - Our experience and data shows that developments with a larger number of end connections are more likely to be undertaken by independent competitors.
 - Therefore data should be sub-divided based on the number of end connections.
- Some of the data that Ofgem proposes to collect will be distorted and misleading:
 - Share of quotation data provided by the existing electricity distributors (DNOs) will be distorted and should not be gathered. Independent connectors can provide quotes to connectees without DNOs ever being aware (using a section 16 quote). This data, if gathered, would not be complete or representative.
 - Market share data for unmetered connections, with their low power requirements, will omit the very real competition DNOs face from new non-network technology. This national competition should be recognised. Network only data will be misleading for specific types of unmetered connection.
- By focussing solely on DNO market share, Ofgem will also be unable to test whether the overall market is effective.
 - More holistic data on market share of each participant is needed, both in terms of constructing connection assets and in terms of adoption of the resulting network, to calculate some valuable measures of competition.
 - Customers gaining a quote from an ICP (or IDNO) might not actually be obtaining any independent quotations, since they might ask the “independent” competitor to gain a section 16 quote on their behalf. This has scope to cause customer detriment, which DNOs cannot mitigate, and understanding this market behaviour would require a specific customer-oriented study to understand.

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1. Question responses

1. Northern Powergrid's responses to the questions in Ofgem's *Proposal to review competition in the electricity connections market for RIIO-ED2* (the Consultation) are set out below; under each of the three headings that Ofgem uses in the Consultation.

2. The proposed scope of the review

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

2. We do not think the current RMS classification captures all the distinctions that apply.
3. This is the case for low voltage metered developments where there are multiple end connections (for example housing estates or trading estates). The competitive dynamic differs between those developments with a small number of end connections and those with a large number. Therefore Ofgem should capture data for the "LV other RMS" segmented by the number of end connections. This would allow it to distinguish larger projects (e.g. 20+ or 40+ end connections) from work involving small numbers of end connections.
4. It is also the case for the "unmetered – PFI" segment, which should be revisited:
 - a. we understand this segment was originally intended to capture high volumes of unmetered connections undertaken during the initial, capital intensive, phases of private finance initiative (PFI) arrangements, so they did not distort the overall market share figures;
 - b. we see no reason to distinguish small numbers of unmetered connections under the ongoing "capital maintenance" phase of a PFI arrangement from others procured by a Local Authority.
5. For many unmetered connections there are now also genuinely competitive alternative technologies, such as a solar powered unit with a battery. These alternatives offer effective competition due to the low power requirements of unmetered connections. We have seen extensive use for unmetered connections like road signage lighting, road LED displays, and parking meters (i.e. in the "unmetered other" segment).¹ It is possible that these alternative technologies have already rendered unnecessary the price control regulation of network connections in some circumstances. It is also possible that they mean a national market definition (and a national market study) would be

¹ It is becoming increasingly common to see new street furniture – for example lit road signs or signs that display the speed of passing vehicles – with attached solar panels and no outward sign of a network connection.

appropriate, rather than a local focus, since the competing technology is available and priced in the same way nationally.

6. In other parts of the market we have not identified reasons to supersede the original RMS definitions.

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.

7. Yes, we agree.
8. Connectees are being effectively protected by regulation in the excluded market segments, and the value of the work potentially subject to competition is relatively low.
9. Ofgem needs to focus its resources on higher value and more pressing issues that may be causing consumer detriment, like the current relative price control for IDNOs. With more than a million energy network connections to IDNO networks it is essential that Ofgem review whether:
- a. the relative price control first put in place well over a decade ago is still appropriate; and
 - b. the uneven playing field currently in place in terms of tariff support for connection charges is serving energy consumers (as distinct from housing developers) or harming them.
10. On this second point, it is apparent that the current IDNO tariff support system is not in the interests of energy consumers. Although tariff support will reduce the connection charge to a housing developer (or create an ongoing revenue stream for it), the adoption of these new, low cost to serve connections, by IDNOs means that average network charges are higher than they would otherwise have been for all energy consumers.
11. In effect, tariff support creates a cross subsidy from energy consumers to housing developers. It therefore acts to the detriment of energy consumers.

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.

12. We support Ofgem's proposal on the basis that Ofgem will be aware of any specific instances where a review is necessary.
13. Under Part C of licence condition CRC2K, licensees report annually on segments that have previously passed the competition test, including "the extent to which the evidence relied on by the licensee in its Competition Notice ... is still accurate"
14. This reporting should allow Ofgem to identify any specific segments, and particular parts of the country, where the level of effective competition has materially diminished.

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

15. No, we don't agree with this proposal, for the following reasons:
- a. "Share of quote" data may be distorted and misleading, and a partial dataset like this is not worth collecting. This is because:
 - i) When DNOs provide a section 16 quote, they provide a dual quotation (including a quote for only the non-contestable services and a quote for all the work associated with providing the whole of the connection).
 - ii) Where the quote for non-contestable services is used by independent connectors to provide further quotations, DNOs will not know how many such quotes have been provided.
 - iii) Share of quote data calculated by DNOs will over-state DNO market share, by an uncertain amount, negating its value.
 - b. By focussing solely on DNO market share of completed connections, Ofgem will also not be able to test whether the overall market is effective. For example:
 - i) Ofgem will not be able to calculate common indicators of competition, such as the Herfindahl-Hirschman Index (HHI) unless it also gathers data on the market share of other market participants.
 - ii) Market share data for unmetered *network* connections, with their low power requirements, will omit the very real competition DNOs face from non-network technology.
 - c. Customers gaining a quote from an ICP (or IDNO) might not actually be obtaining any independent quotations, since they might ask the "independent" competitor to gain a section 16 quote on their behalf, and this has scope to affect customer outcomes greatly.
16. To perform a more effective review, Ofgem should gather more holistic data on the market share of each participant, in terms of:
- a. constructing connection assets; and
 - b. adoption of the resulting network.
17. A national study would be appropriate to understand whether and for which types of unmetered connection an alternative power supply technology (e.g. a solar panel plus a battery) offers a viable and cost competitive alternative to an unmetered network connection.
18. Ofgem would need to speak to connection customers directly if it wishes to better understand market dynamics where "independent" competitors have sight of DNO quotations, and whether genuinely effective competition is protecting connectees in these instances.

3. Possible outcomes from the review of competition

A. Questions in respect of an RMS that does not pass the competition review, but where Ofgem considers 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.

19. Ofgem should not apply price control incentives in such cases.
20. If there is a prospect of competition developing, incentives could potentially prevent or slow competition from developing. This could harm energy consumers in the longer term.
21. In the shorter term, connectees will still be protected by a regulated price and the relevant licence obligations in respect of competition in connections combined with the prospect of enforcement action. Therefore any costs from the lack of price control incentives are likely to be relatively low.

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.

22. There is, potentially, some reason for Ofgem to consider increasing the margin for those segments where competition has not yet developed (but where Ofgem thinks it might).
23. This is because, in setting the margin, Ofgem must strike a balance between:
 - a. the benefits from a higher margin (in terms of greater prospect of longer-term benefits from competition developing); and
 - b. the immediate costs to connectees of a higher margin.
24. When the 4% margin was set, Ofgem was striking this balance in respect of all the regulated segments.
25. Ofgem is now considering the margin only in those parts of the market where a 4% margin has not helped competition to develop (and where Ofgem thinks competition could develop). It logically follows that:
 - a. A higher margin than 4% might be necessary to stimulate competition in the near term.
 - b. The immediate costs from setting a margin above 4% are lower than in 2010, since the regulated margin now applies to much less of the overall market.

B. Questions in respect of an RMS that does not pass the competition review, and where Ofgem considers 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.

26. We see little reason for Ofgem to apply price control incentives, of the type it is proposing, for these segments.
27. If there is some prospect of competition developing, incentives could potentially reduce the likelihood, or speed of this happening.
28. If there is no prospect of competition developing, the regulated price of connections, alongside the relevant licence obligations in respect of competition in connections (combined with the prospect of enforcement action) will protect customers.

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.

29. Whether the margin should be removed will depend on how certain Ofgem is that competition will not develop, because this affects the balance Ofgem must strike in setting a margin (which we describe in response to question 6 above).
 - a. If Ofgem is certain competition will not develop, it is difficult to justify connectees continuing to pay a margin since they will never receive any benefits from it.
 - b. If Ofgem is not certain, the margin may be justified, because potential longer-term benefits from the development of competition might outweigh immediate costs from a margin.

C. Questions in respect of 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.

30. If competition is effective price control incentives should not be applied.
31. Price control incentives are typically designed to try and mimic the effect of competition. If competition is effective then applying them may distort the outcomes of the competitive process.

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.

32. If competition is effective then a price control should not be applied, for the same reasons that price control incentives should not be applied (see above). In other words, DNOs should be able to charge an unregulated margin in such circumstances.

4. Proposed approach to reviewing competition

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.

33. As set out in response to question 5, we do not consider that the indicators proposed (hence the assessment criteria) will allow Ofgem to effectively review whether competition is protecting energy consumers.
34. Any review of competition in connections needs to consider much more than “whether third party presence has expanded or decreased over time” to understand whether consumers and connectees are being fully-protected by the competition which is actually taking place.
35. Moreover, with more than a million energy consumers now connected to IDNO networks, it is essential that Ofgem review whether the relative price control first put in place well over a decade ago is still adequate to protect energy consumers (for the reasons explained in response to question 2). This should be a bigger priority for Ofgem’s resources than whether the market for new connections in the next few years in some parts of the market is protecting new connectees, since the potential consumer detriment from any excess profits being earned by IDNOs on all energy consumers connected to their networks could be far larger.

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?

36. We agree with Ofgem that the Covid-19 pandemic has been capable of distorting the 2020/21 data. Therefore, if the data was gathered, it is unlikely that Ofgem could place any weight on it.

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

37. We think the template should break the LV (other) segment into bands to distinguish developments based on the number of end connections (e.g. 0-10, 20-20 and so on), and should include data to calculate market shares based on the number of end connections. This would allow Ofgem to evaluate

competition in, say, connections that involve 20+ or 40+ end connections to a network separately from those that involve fewer end connections.

38. Data on total capacity could similarly offer a distorted view of market share. Individual large capacity connections would receive a high weight in the share calculation, even though they might involve no additional contestable work compared to a smaller capacity connections.
39. Some of the data in the template is also not routinely captured for regulatory reporting purposes, in particular data on reinforcement and total capacity. Although we do capture this information in our systems, it will require additional data assurance and manual validation work to ensure it is appropriate for Ofgem's work. In light of the resource burden (and ultimately longer term red-tape costs that will fall on energy consumers) we would ask Ofgem to consider whether it has a meaningful need for this data.
40. If Ofgem decides that it will not review market segments that have already passed the competition test (in response to question 3), Ofgem should instruct DNOs to only complete the template in respect of segments which have not passed the competition test (in effect cells for segments that have passed the test should be greyed out on a DNO-specific basis). This will avoid un-necessary administrative expense (helping reduce long term costs to energy consumers) and reduce the amount of unnecessary data that Ofgem receives.