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Ms Rebecca Langford
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Dear Rebecca

RE: GAS AND ELECTRICITY CONNECTIONS INDUSTRY REVIEW 2007-08

Thank you for giving us the opportunity to respond to the above Review, responses to the individual questions are set out overleaf:

Despite the economic downturn, applications for points of connection continue to increase at a significant rate year on year with a further 20% increase since October last year, with large fluctuations over very short periods (two months: 134%), the numbers of accepted quotations are also increasing and so we believe that this demonstrates that competition is moving forward.

The Review contains connections data that is aggregated across the different market places such as large domestic sites, commercial sites and single one-off connections. We believe that by disaggregating the data, a picture of the true extent of competition in connections would be revealed that would identify those areas in which there is no appetite for competition from those in which competition has been quick to evolve. The decision to include modified connections (which are rarely competitive in nature) within the new connections data is further skewing the perceived levels of competition in the electricity sector.

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Disaggregation would allow for a more focussed approach to identify the reasons for the slow growth of competition in perceived competitive areas.

There are barriers to competition; Independent Connections Providers (ICPs) are disadvantaged as they have no statutory powers to work in public highways, whereas both Distribution Networks Operators (DNOs) and Independent Distribution Network Operators (IDNOs) already have these powers. Adoption payments also skew the market in favour of Independent Gas Transporters (IGTs) /IDNOs, as Network Operators cannot offer such payments

The document provides many comments on the work of DNOs from data provided both by the DNO and by ICPs and IDNOs, it does recognise that data relating to the connections made by third parties is not available. However we believe that to give a balanced view of the market, particularly the performance of third parties and the reasons for the success or failure of competition, this missing performance data needs collecting in respect of third parties to reveal the true measures of success from the ultimate end user.

For the two Central Networks distribution areas (Central Networks East and Central Networks West) the SLC15 data included in the Review shows that the guaranteed standards were not met on occasions. Having addressed the underlying problems and also procured and developed a new data-base to assist us in monitoring the progress of applications, and which at the same time provides visibility of the process for external customers, we are pleased to confirm that the recent performance has been much improved.

Since the publication of the Review of Competition in Gas and Electricity Connections Proposals Document (26/07), we have continued to make significant steps in improving the service we provide. The Good Practice Review has identified key areas where customers have requested improvements and we have progressed further against the “traffic lights checklist” since the August return, as well as against our own customer-driven change programme.

We have taken major steps to improve our levels of performance within unmetered connections along with the quality of the data for reporting against the standards; we have moved this activity in-house which will give us greater control of resource and hence the service levels and data reporting. Although there is still progress to be made, since this move we have seen a trend of improvement and this impact should be seen in the 2008/09 reporting.

Although we have been approached by a Public Lighting Authority (PLA) to discuss rent-a-jointer and by other parties for their Private Finance Initiative (PFI) bids in our region, we have not had take up of this service. However we do provide a bulk column service product which is very similar to rent-a-jointer in enabling the PLA to carry out the civil work. This is preferred by some of the PLAs in our region as the risk of productivity sits with us rather than with the PLA for rent-a-jointer.

There are similarities between the gas and electricity sectors, however it would appear that the initial differences in the development of competition in both markets may have given rise to the more pronounced differences highlighted in the document. Initially there was a lack of price regulation in the gas market, to the detriment of customers which was not mirrored in the electricity market, which kick-started competition in the gas sector. Meanwhile since 2003 Transco (NGT) adopted a market exit strategy, as a single entity holding 12 distribution zone licences until network sales in 2005, it proceeded with the aim of reducing its share of the market and its obligations under its licence to operate.

Overall, we are disappointed in the way the Review was presented; we believe that by disaggregating the data it masked the true level of competition in the electricity sector as a whole, and more locally in the Central Networks distribution service areas. The representation of Central Networks performance against the standards was similarly disappointing, as we continue to make significant progress in facilitating competition, and have publicly received feedback to this effect. We have been constantly improving our metered and unmetered connections provision

following direct feedback from customers, and whilst standards may have been missed on occasions in the past, the recent data is more reflective of the significant effort made.

We have provided full answers to the questions posed, however, if you have any additional queries, please do not hesitate to contact me direct.

Yours sincerely

Julie L'abraham
Policy and Compliance Manager

Chapter two: Gas Connections

1 *Is the data we have collected reasonably representative of connection charges levied by GDNs and IGTs, and adoption payments made by IGTs and GDNs?*

We are not in a position to make any comments on this question.

2 *Are adoption payments the main reason why ICPs have a much higher market share in connection to IGT networks than GDN networks? Are there any other factors that account for the fact that only 5% of connections to GDN networks are installed by ICPs?*

Yes we believe so. The adoption payments made by Independent Gas Transporters (IGTs) are a very significant factor ultimately negating the cost of building the connection. We also believe that the additional costs incurred by ICPs as a result of obtaining appropriate notices under the New Roads and Street Works Act (NRSWA) and S50 Town and Country Planning Act (TCPA) to work in the highway will mean that ICP costs could ultimately be higher unless they are working on behalf of a statutory undertaker.

The end to end customer process is very different for ICPs depending on who they are working for, and therefore they are limited on the date commitments they can make up front, without taking on unreasonable risks.

Where the IGT is actively looking to attract assets the ICPs tend to work on behalf of the IGT and they are, therefore, either working on large sites away from the public highway or are working as an agent using the IGT's statutory authority in the highway. When they work on behalf of their own client they are working on off-road sites without adoption payments, or in the highway under a S50 planning application. This is a very different proposition when presenting a proposal to a client and effectively disadvantages the ICP due to the lack of date certainty for

gas-on.

Control of reinforcement is another significant factor, as once the IGT connection is made usually the reinforcement is already complete. The rest of the network can then be built and control of commissioning rests with the ICP. When working on behalf of a GDN, the adoption rules require that the network is constructed first and then commissioned in phases. The reinforcement is therefore, not able to be accessed until the commissioning date, and is controlled by the GDN. In effect, the customer proposition from the ICP is still dependent upon the actions of the GDN. Because of this, ICPs are forced to compete on price not service and whilst price is important, we believe that it is of lesser value when traded against certainty of gas-on date.

3 *What factors enable IGTs to make adoption payments of these magnitudes? Do they have lower costs of operation, or are other factors at play, such as the degree of headroom in the relevant price control?*

IGT's adoption payments reflect the different commercial environment that exists in the gas market due to the difference in asset life and subsequent maintenance costs.

A modern gas network will be constructed predominantly below ground and mainly of decay resistant polyethylene (PE) plastic. These networks currently have an expected asset life of 50 years plus with lower fault activity and subsequently a much higher net return on investment over the life of those assets. This facilitates a relatively higher adoption payment than could be made using the same rate of return on shorter asset lives.

Furthermore, these businesses are generally, only dealing in new assets and therefore make a higher net margin from the same levels of Use of System payments than an asset owner with a mixed asset portfolio. IGTs (and IDNOs) have a much more localised obligation to connect under the S16 connector of last resort provisions with more focussed geographical patches that allow for a more concentrated

support network which in turn reduces the overhead required to support it, compared to a more general obligation imposed on the GDNs. They tend to select larger jobs and do not build domestic one-off connections.

IGTs are able to run with a lower overhead given their ability to select work. Crucially, this market model can only function with the presence of GDNs but GDNs can function without IGTs and therefore can select attractive work that fits with their asset portfolio. Such 'cherry-picking' will ultimately be to the detriment of other higher cost to serve customers.

4 *What factors lead IGTs to charge lower connection charges? Are ICPs/IGTs more efficient at installing the connection or are other factors at play?*

The nature of the connection would have an impact, with relatively large economies of scale available for large greenfield domestic sites of many hundreds of new-build homes. IGTs/ICPs tend to carry out new building connections which are unhindered whereas the GDNs typically work in existing network areas with the more costly issues associated with existing infrastructure such as public highways.

IGTs are generally connecting on to assets constructed within the last ten years. They are made of PE plastic, have very high degrees of records accuracy and are subject to very little overbuild. They are also, generally, located in areas of recent development so they have low material diversity, high service accessibility and relatively much higher network capacity and resilience. ie. foreseeable reinforcement has been a strategy in gas for the last twenty years as the incremental cost of upsizing is so low.

IGTs also carry out the installation of other utilities, reducing the overall construction charge, and hence benefiting by obtaining increased economies of scale.

5 *What impact does the contrasting nature of GDN and IGT*

price controls have on competition in gas connections?

GDNs are unable to make adoption payments for assets whereas IGTs have this ability, this differential alone increases competition purely on a cost basis giving no ability for the customer to make a qualitative decision.

Chapter three: GT performance against guaranteed connection standards

1 *We seek consultation response on whether stakeholders agree that performance standards are as high as reported, and what lessons can be learnt from the gas connections industry and applied to the electricity connections industry?*

We believe that the GT performance standards are accurate and also note the different development path that competition in the gas industry has had in comparison to the electricity sector. See also our response to Question 4 above.

The technical differences between gas and electricity and their relevant transportation systems gives rise to different considerations in respect of operational and safety controls. This necessitates non-contestable elements in the provision of electricity distribution services that are not necessary in the gas market, and hence allows more gas related activities to be carried out on a contestable basis without risks to the safety and security of supply or safety of electricity workers or the general public.

Chapter four: Metered Electricity Connections

1 *Why has competition been so slow to develop in electricity connections compared to gas, and what measures if any, should be taken to address this issue. In particular we seek responses on the following theories for the relatively slow growth of competition in electricity connections:*

a *The relative price control operating in gas gives IGTs a relatively high revenue compared to their underlying*

operating cost, whereas margins are slimmer for IDNOs?

Please see the reference to early market developments in the gas sector, as discussed in Chapter 2, Question 3 above.

b *There remain significant barriers to competition in electricity, whether real or perceived, which prevent effective competition from IDNOs and ICPs. If so, we seek consultation responses on the nature of the barriers, and what measures should be implemented to address them?*

There are contestable areas that are not attractive to ICPs or IDNOs, (for example one-off domestic connections, urban developments, developments necessitating street works or overhead line work) as there is little interest in this type of work. We believe that these projects must therefore produce only a very small profit margin and that the ability of regulated entities to recover only reasonable costs must therefore be the most cost reflective and appropriate charges.

ICPs make their returns on the profit from the capital construction project. Therefore, they will focus on the more lucrative projects by reference to margin and turnover. IDNO's make their returns from the differential between the cost of financing the asset purchase (including maintenance charges) and the Distribution Use of System (DUoS) income arising from the supply dynamics. Neither of these models support high volume growth in small connected loads (unless all loads are connected at the same time in the case of a housing development site). The principal focus to date has been to target larger schemes and price by reference to a relative discount on the host DNO price. To assess this focus, Ofgem should look to disaggregate the connections data across the various observable markets in order to show which are attractive to competition and the relative effectiveness across geographic boundaries.

IDNOs should have lower operating and maintenance costs than DNOs primarily due to the age and typical geographical position of their networks. Hence, there are only certain connections that will appeal to the IDNO business strategy, and again, single or small domestic sites and overhead lines are unlikely to feature. The figures produced are not sufficiently disaggregated to show what the level of IDNO penetration is in this limited area.

The technical and operational issues do present barriers, particularly in the form of local network control. In terms of technical capability and scales equivalence, gas and electricity have similar levels of technical complexity in the management and construction of connections. In effect, once on site and in the trench the challenges are different but analogous. There is a fundamental technical difference in the level of local control that is available to ICPs and IDNOs. In the gas market it is possible to locally control sections of pipe in the distribution network down to street and often property level. This allows a limited level of live gas operations to be delegated to competitor organisations but opens up a considerable number of projects to competitive opportunity (effectively up to 85% of all gas connections) of which a significant proportion has been taken up.

Reinforcement still plays an important part in how these jobs are carried out, but the tiered reinforcement regime also facilitates a degree of local control being handed to third party connections organisations. In the electricity connections market, however, local control cannot be delegated to the same extent with an equivalently lower level of flexibility. Cables cannot be ‘squeezed off’ or isolated in a similar way below substation level. Therefore, there is a technical threshold affecting the jobs that can be opened up for competition working on the existing electricity network as opposed to building new network extensions.

Chapter five: Metered Connections - Performance against standards

1 *Why has there been limited reporting against the SLC15 performance standards and what measures should be taken to address this issue?*

The SLC15 standards have been in place now for over a year and it has become apparent that there are areas for which there is either currently very limited, or no appetite such as LV generation. There are also some areas where it can be expected that there will be an increased demand for renewable generation in the future, which should translate into connection requests, once the planning and technical issues with plant and innovation are resolved.

The way that the data was presented in the Review meant that a narrow failure against the standards gave rise to the portrayal of a complete failure, whereby the margin was very narrow. We have carried out an audit of the data and are satisfied that it is accurate.

2 *There are standards relating to the provision of non-contestable services where the connection is being provided by an alternative provider. However, the vast majority of contestable activity is still carried out by the incumbent and not all of this activity is covered by service standard reporting. Therefore we seek feedback on whether it is appropriate to extend the scope of service standard requirements / reporting to the provision of connections not currently covered, and if so, what form this scope extension should take? For instance we have 30 or 40 day standards for straightforward connections, but no comparable service standards with regard to non-straightforward connections (i.e. the majority of larger connections).*

Since the introduction of guaranteed standards, DNOs have improved the service they offer and some customers may simply prefer to defer to them to provide their ongoing connection requirements. No data is collected from 3rd

parties and so performance standards are not transparent. Very few contestable connections are requested by individuals or firms that have no previous experience of the market, and it is possible that they may have a desire to continue that relationship due to wide and varied reasons such as good service or due diligence checks, just because competition is available at a perceivably reduced rate, it doesn't mean that all customers will choose that route.

3 *Data generally suggests that standards are being met. However, this is not consistent with the fact that we receive significant numbers of complaints with regard to the service quality from end customers, ICPs and IDNOs. Why is there an apparent inconsistency between reported standards, and the level of complaints received? How should this issue be addressed?*

Some of the complaints that are pursued through Ofgem relate to issues that are already being discussed and debated through appropriate industry forums such as the Electricity Connections Steering Group (ECSG), these involve, for example, health and safety and operational issues. Such complaints could be deferred until the industry has had an opportunity to complete their deliberations. Due to their business models, IDNOs and ICPs are keen to challenge not only the speed of evolution, but also the direction. Rushing decisions for purely commercial reasons may result in unnecessary complications and debates in the future, challenging the provision of a safe and secure network.

Where Ofgem receives a complaint that suggests a service standard has been breached, yet this is not apparent in the reported compliance then the DNO should be required to investigate that non-compliance and report to Ofgem on their overall reporting framework. Given that the reporting is to be audited annually, any systemic issues should be identified. In cases where data is found to be omitted, Ofgem should carry out an audit to ensure that the appropriate improvements have been made.

For the end customer, the best practice review has gone some way to address the issues that customers are having despite the standards being met. Central Networks change programme is striving to exceed the minimum standards and recognises the need to provide excellent service for all customers including those outside of the standards.

Chapter six: Unmetered Electricity Connections

1 *In the light of generally disappointing performance, Ofgem seeks views from interested parties on whether they believe that it is appropriate to continue with the currently voluntary arrangements, or whether Ofgem should seek to introduce either financial incentives (as part of DPCR5) or specific licence conditions with regard to performance standards in unmetered connections.*

In order to introduce financial incentives or specific licence conditions within DPCR5 we would seek a final agreed format for the data between DNOs, Ofgem and the Public Lighting Authorities as there is still some debate around this at the ECSG. It is important that both parties are producing only one set of data for the purpose to avoid unnecessary costs.

Chapter seven: Electricity Connections – Good Practice Review

1 *In the light of experience, did Ofgem's Good Practice Review target the appropriate areas?*

Yes, we believe so, it largely reflected the results we had seen from our own feedback from our customers, and as a result we have made very good progress in the development of our connections process. Developing further the website making it an interactive rather than purely information based site, at the same time we have implemented online applications for metered connections, online quotations for diversions and service alterations and online ordering for lighting authorities for unmetered connections.

A number of tools and resources have also been created to improve transparency and help first time and repeat customers to understand the connections processes, these include a filter to find the right service type and service specific guidance notes. Website development is continuing to include more functionality to speed up the process and increase the information available to the customer about their connections requests.

In delivering the service level improvements we used the feedback from our engagement with our customers.

2 *Do the DNOs' reports of their own performance in implementing the Good Practice measures (as per our checklist) accord with their own customers' and other market participants' perceptions of their performance?*

We have seen a reduction in the overall number of complaints from 2007 to 2008 and a reduction in the number of enquires and complaints that were escalated to Energywatch by our connections customers. We therefore believe that this supports the work we have carried out to date aligned with the Good Practise Review.

These changes need some time to truly demonstrate a reflective step-change in customer performance.