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Dear Sirs

Gas and Electricity Connections Industry Review 2007-08

We are pleased to have the opportunity to respond to your consultation on the development of competition and the effectiveness of regulation in the area of connections. We have been encouraged that Ofgem are recognising the importance of connections and in particular are reviewing the different levels of development of competition with a view of introducing additional incentives as part of the current distribution price control review. Electricity North West has been encouraging the development of competition in connections for several years. We have been proactive in the way we have organised our business and have led the way in innovations such as live jointing schemes. We believe that we have made a significant contribution to the effective connections market that now exists in the North West of England. We have set out our response to the questions raised in your consultation below.

Chapter 2 & 3

As we have limited experience of the gas connections market, we shall limit our response to the questions in Chapters two and three to the following general points.

We note that the data on connection charges exclude charges levied by Independent Connection Providers (ICPs) and therefore cannot provide a complete and accurate picture of costs.

It is difficult to conclude anything other than adoption payment having a significant impact on the gas connections market. It is not surprising that only 5% of Gas Distribution Network Operator (GDN) connections are provided by ICPs as ICPs can obtain significant adoption payments from Independent Gas Transporters (IGTs) that GDNs do not provide.

Based on the relative level of average connection prices, it is actually surprising that GDNs have retained 44% of the total market when they charge £800 per connection compared to £200 for IGT connections. Whilst the IGTs are probably targeting low cost to serve customers and possibly have a lower overall cost base, this cannot explain such a wide difference in

connection charges. The answer probably lies in Ofgem's statement that the Relative Price Control in gas gives IGTs relatively high revenues compared to their underlying costs. Ofgem need to investigate this: is the reason that new networks have significantly lower operating costs than the older average networks that have been used in setting prices for the relative price control or have the margins available to IGTs been miscalculated.

Adoption payments of up to £300 per connection are obviously a significant attraction in the housing market and likely to encourage developers to actively choose IGTs. The ability to offer asset adoption payments to secure new connections would seem a logical commercial choice for IGTs, particularly where they can essentially pass those costs on to the ultimate end user of the property. It seems a logical conclusion that this different regulatory treatment allows a significant commercial advantage to IGTs in their ability to secure new connections.

IGTs have no obligations to make connections and therefore are able to choose which projects to actively seek to secure. They can effectively only quote for projects that are economically viable. This results in GDNs having to carry out less attractive connections as they retain obligations to connect.

Due to the commercial freedom to operate, outlined above, it would seem that IGTs could become more efficient. If multiple, low value jobs do not have to be completed and only larger projects won, then this will provide greater opportunities to make operating efficiencies. Furthermore, IGTs can scale their overheads to the volume of work they are targeting without the need to ensure they are able to meet undefined levels of universal service obligation.

The approach of National Grid Transco has also had an important impact on the level of competition in gas connections. The impact of the regulatory fines they incurred, together with the regulatory disincentives outlined in the document would appear to have led them to make the strategic decision to exit the connections market where they can. This clearly demonstrates that the role of the licensee is vital in stimulating the market. Ofgem need to consider whether this is the outcome that they wish to see for electricity connections. However, for DNOs to exit all or part of the connections market would need a change to primary legislation to remove their obligations to offer terms to connect.

Chapter 4

We are disappointed that Ofgem have used such broad-brush analysis of the level of competition in electricity connections. The level of competition in the North West is at a commensurate level to that of gas connections. In the ENW area, only 62% of connections made in 2007/08 were made by the licensee. We would also point out that the inclusion of modified connections in the data return this year has added additional "connections" to those done by the licensee (as they are currently non-contestable) and has an impact on how the level of competition is perceived. If modified connections and one-off connections (where ICPs do not tend to compete) are removed from the calculation, then ENW, as the licensee, only has a 57% market share of the underlying "competitive" market. This level of competition is markedly different to the majority of other DNOs and the averages quoted by Ofgem. We firmly believe that regional markets exist for connections and this has been supported by

research that we have commissioned by industry consultants IPA and previously shared with Ofgem. We therefore conclude that Ofgem should consider the level of competition in each DNO independently rather than looking at an industry average.

Competition in connections ought to be driven by costs and service levels, however the document indicates that competition in gas may be distorted by the charging regimes which provide high revenues compared to underlying costs. Ofgem need to look at the charging regime in gas to ensure that the margins are justifiable and are not distorting competition.

In the consultation, Ofgem have highlighted the 26% market share in ENW carried out by third parties but we have previously explained to Ofgem that we do not believe that the competitive connections business of United Utilities should be considered as an affiliated ICP. This business has always been treated on a separate arms length basis and since the purchase of ENW by Colonial First State and the International Investment Fund, there has been no contractual or ownership relationship with this business. Indeed, we understand that this business is now providing quotations to IDNOs who directly compete with ENW. Ofgem must recognise this fact in future reports and decisions and report the connections made by this business accurately as non-affiliate connections.

The barriers to entry are not due to the scope of contestability as this has clearly not hindered the development of a competitive market in the North West as outlined above. We believe that the proactive approach taken by ENW and before that, United Utilities has had a fundamental affect on the level of competition that now exists. We have organised the business to focus on supporting the ICP market and this is evidenced by the significant number of enquiries handled by ENW. Ironically, there is a disincentive for DNOs to put such resources in place as having to deal with additional quotations etc results in additional resource requirements that are treated as indirect costs by Ofgem. This potentially leads to a misleading impression of inefficiency when Ofgem undertake comparative analysis of DNOs.

We strongly believe that Ofgem need to provide some positive incentives to reward DNOs who have actively supported Ofgem's principal objective. We welcomed Ofgem's recognition of this in their Initial Consultation on the Electricity Distribution Price Control Review in March 2008 where the allowance of margins into connections charges was discussed. The evidence reveals that the competitive market is now effective in the North West and that Ofgem need to make demonstrable recognition of the progress made by ENW.

Chapter 5

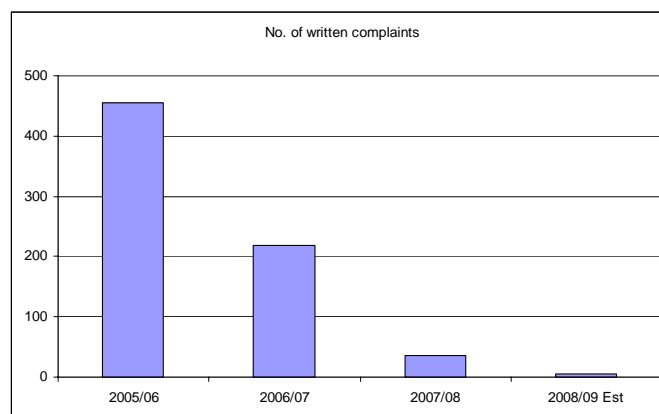
Question 1

We do not believe it appropriate to comment on whether other DNOs are reporting correctly against a licence condition. We believe that we are reporting correctly against both the letter and the spirit of the guidance document that supports the licence condition. We contributed actively to the work of ECSG in developing the guidance as we believed it was important to develop and agree the level of clarity set out in the guidance document to ensure consistency of reporting. We would note that some specific activities are relatively low in volume even in competitive markets.

In terms of addressing any concerns we suggest Ofgem utilise their powers under SLC 15 to review the audit carried out by any DNO where they have concerns and, if required, revise the guidance with the aim of “removing or reducing inconsistencies between Electricity Distributors in their interpretation and application of those provisions and improving the form or manner in which, or changing the frequency with which, information is collected, provided or reported under any requirement of this condition”. In addition Ofgem need to look at the underlying reasons why competitive activity is high in some areas and not others: improving the level of competitive activity throughout the country will increase the level of reporting.

Question 2

As documented in the consultation, DNOs currently report to Ofgem under both SLC 19 and the 30 and 40 day standards. In our area, we do not see that increasing the regulatory reporting burden is necessary. The existence of a competitive market guards against complacency in terms of service provision. In fact in the past we have had ICPs complain that providing a good service in terms of issuing statutory quotes was anti-competitive. Whilst customers clearly have the option to have their connection made by an ICP or IDNO, those that choose a statutory connection appear to be satisfied with the service. We base this on the feedback we get from customers and the exceedingly low level of complaints that we receive (three to date in the current financial year) and shown in the graph below.



This issue could however provide an opportunity for Ofgem to differentiate between DNOs by only applying additional reporting regimes where the actual level of competition is low. This

would provide a positive signal to DNOs and also add the level of protection to customers that Ofgem appear to be concerned about.

Question 3

Our data shows that generally standards are being met. Furthermore, Ofgem will be aware that we have improved our performance significantly in the first two quarters of this reporting year which are not included in the CIR. As previously mentioned, the level of complaints we receive is very low and therefore our experience is of consistency. We have two general observations of the introduction of standards. Firstly, customers do not always expect or are satisfied with DNOs meeting the service standards set by Ofgem. Clearly the fact that the target is 90% means that up to 10% may be outside the standard and the licence condition still met. Measures of complaint levels and customer service are also important. Secondly, the fact that DNOs are now reporting under a formal licence condition may drive behaviours resulting in a focus on meeting the standard rather than providing excellent customer service.

Chapter 6

Question 1

In our view it would be premature to move away from the existing voluntary standards for unmetered connections. Definitions have only recently been clarified and it is not clear that all data is being reported to Ofgem on a consistent basis. We have previously highlighted to Ofgem the concerns of the North West Street Lighting Steering Group who prefer a different method of measurement of performance than has been proposed nationally. We have been pleased that Ofgem have recognised the need to provide reports that our customers find useful and not burden those customers with any additional costs to provide additional reports.

We accept that our reported performance has room for improvement but we would point out that the method of measurement agreed with our customers is more onerous. We work closely with our customers to keep them informed and are focusing on clearing some short term backlogs. As a consequence these results will continue to show a deterioration in performance until the backlog is totally cleared.

In our Steering Group we have discussed the role of the Local Authority in helping us improve delivery and meet the levels of service they desire. We have agreed to develop some performance metrics to show the volatility in the work issued to us. The Local Authorities now recognise that a steady workflow improves performance and efficiency. We have also agreed to identify the number of abortive jobs for each local authority so improvements can be made to communications and work flows. It is important to recognise that the actions of various Local Authority organisations have a bearing on the performance and level of service that they receive.

Again we would be interested to understand if Ofgem are proposing any positive financial incentives or really just considering the introduction of further sanctions.

In summary, we believe that ENW have an effective competitive market in the North West. Bold decision making by Ofgem in response to this evidence of effective competition in connections could send a very strong signal to some other DNOs to modify their behaviours and do more to facilitate competition in connections. This would ensure that it develops across the rest of Great Britain as it has evidently done in the North West.

If you require any further information please do not hesitate to contact me.

Yours sincerely,

Paul Bircham
Regulation Director
Electricity North West Limited