

Connections Policy
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

13th February 2009

For the attention of Rachel Fletcher – Director, Electricity Distribution

Dear Rachel,

Electricity Distribution Price Control Review Policy Paper 159/08

The following response is made on behalf of the MCCG. We have a number of representatives on the Electricity Connections Steering Group and our members are fully active with the Competitive Connections market and committed to developing competition and removing the monopoly of the DNO's for the overall benefit of customers within the market place.

The MCCG welcomes the opportunity to express its views on the relevant sections within the Electricity Distribution Price Control Review policy paper and we look forward to working with Ofgem in the most appropriate and effective manner we can, to ensure competition is allowed to flourish within this market.

We are focussed particularly on the area of customer connections and as such our response addresses the area of customer connections.

3. Customers

Question 4: Do you agree with our proposed approach to connections, which of the options do you support and why?

Clearly the approach of regulation taken to date to promote the development of competition in the electricity connections market has failed. We therefore welcome the principle of financially incentivising DNOs to encourage competition. A similar approach in addition to other measures seems to have been successful in the gas connections market. It is critical however that any incentive offered is earned fairly. There is a need to clearly identify and segregate connections undertaken by third parties as opposed to those undertaken by the DNOs affiliate companies when determining the level of competition penetration in the market.

DNO Margins on Contestable Connection Works

We reject the notion of allowing the DNOs to earn a margin without having to complete the proposed competition test. A margin should only be allowed where a DNO has successfully completed the competition test. The test could be completed as early as the beginning of 2010 and no later than the end of 2012. Taking the test should be compulsory. DNOs who fail the competition test should not be allowed any incentives, given twelve months to show significant improvement or face referral to the Competition

Commission by OFGEM to explain why their DSA (Distribution Service Area) remains closed to competition in connections.

Competition Test Measures

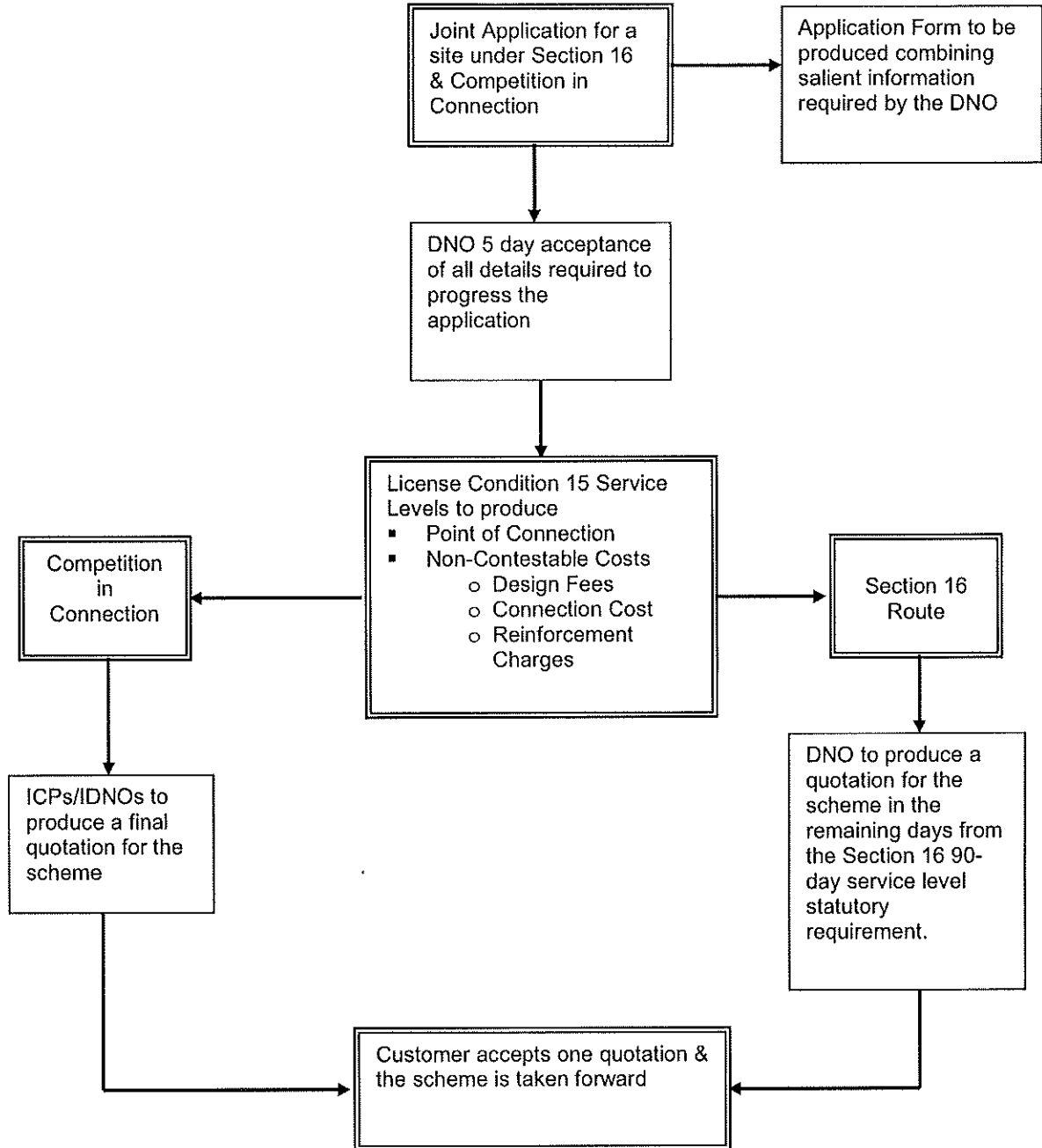
The key measures used to determine the level of competition in any DNOs service area are detailed in the table below.

Proposed Basis of Competition Test

Item No.	Measure
1	All applications (including all S16 which could be competitive) to follow the same timescale path as the SLC15 route
2	Common application formats where on the connection application form the client identifies if he also wants S16 contestable offer
3	Non Contestable costs must be cost reflective & non profit making
4	Non Contestable costs must be benchmarked against Ofgem costing.
5	DNO's with NC's above XX% of DNO average are not entitled to receive margin
6	DNO's with poor Customer Satisfaction index not entitled to receive margin
7	DNO's above xx% market share means they can not obtain margin
8	Procurement of Equipment: Where DNO's specify single source equipment or supply chain makes it impossible/impractical for competitors to obtain equipment then DNO to supply at cost
9	DNO's to ensure all legal processes are simple and clearly mapped out and followed by their staff.
10	Fair and Equitable Adoption Agreements removing the need for NERs accredited ICPs to put a performance bond forward.
11	Simplified payment methods including the use of electronic correspondence throughout the connection and adoption process.

The above list is not exhaustive but we believe they are the main elements that form the basis for the competition test. There may be an opportunity to add weighting to each measure.

Items 1&2 on the above list refer to the combination of the process of S16 and CIC connection applications. We would like to see a single application form in use that has an option to request the DNO to provide a quotation for the contestable element of the works. This procedure is detailed in the flow chart below.



The non contestable costs currently detailed in S16 quotations can be equated simply to the non contestable costs required where the works to be undertaken by an ICP. This will have the advantage of reducing the administration costs on the process as it will reduce the instances of multiple applications for the same site.

It is important to recognise that this process would not require any additions to the current LC15 standards. It would simply mean that a DNO would provide the point of connection info and associated cost in the timescales of LC15 and the remaining contestable costs (if requested) within the S16 timescales on receipt of an application.

This will give the customer the opportunity to go out and test the market should they wish to receive other quotations from ICPs. The successful ICP would then accept the non contestable element of the original DNO's quotation if they were to provide the DNO with written evidence that they have been awarded contract to service the new development.

Allowing the Margin from 2010:

We have serious reservations with the incentives proposed being offered before a competition test is undertaken. In the short term the margin being allowed on the construction of contestable works may possibly the DNOs encourage to further increase their market share in contestable connection activities resulting in a reduction in overall competition in connections. The result potentially being that the margin is taken away again at the end of 2013 if the DNO fails to show any improvement in competition while in the meantime the ICPs go out of business.

Additional Measures:

A further measure to help improve competition may be to expand the financial incentive to also consider the adoption of contestable works from non affiliated third parties.

The DNOs could also be allowed to recover a percentage of the value of contestable assets adopted depending on their score in the Competition Test.

A percentage of the value of the new connections assets adopted by the DNO could be added to the DNO's RAV. This value would be based upon a benchmark unit costing rates that each DNO currently submits to OFGEM.

The percentage employed would be dependent upon the score obtained by the DNO from the Competition Test. We propose a range of 0% to 20% depending upon the DNO's score on the Competition Test.

The advantage of this proposal over that put forward in the DPCR5 consultation paper is that it would be applied to all connection assets regardless of whether they were installed under competition or not.

Whilst it may be argued that this is using DUOS (the contribution of customers in general) to support competition the current proposal is not much different. The effect of allowing DNOs retain the margin they make on the construction of contestable asset will increase the value of DNO's RAV as margins are currently deducted from DNO's RAV.

The mechanism would work as follows:

Contestable activities undertaken under S16

The DNO would be allowed to retain the profit margin whilst a Nett zero value is added to the DNOs RAV as per the current proposal.

Contestable activities undertaken under CIC

A Percentage of the Benchmark Unit Cost of the Contestable Assets will be added to the DNO's RAV.

Both of the above measures would be applied based on the success of the DNO in the competition test.

Program of Implementation

All DNOs would be given the opportunity to complete the Competition test prior to the commencement of DPCR 5 and up to end of 2012. Until such time as the DNOs complete the test no regulated margins would be allowed. Upon completion of the Competition Test the following actions could be possible:

DNO achieves upper quartile Benchmark performance on the Competition Test taken up to end of 2012.

DNO allowed retains 100% of the allowed regulated margin on Contestable Connections work undertaken by the DNO or its contractor and adds the 20% of adopted connections value to RAV

Poorer performance would result in a reduced or zero return and ultimately an OFGEM referral to the Competition Commission.

Cost of the proposal:

The DUOS burden to fund this proposal could be calculated as follows

$$\text{DUOS Burden} = \frac{\text{Total Connections Value} \times \text{CIC Incentive \%} \times \text{CIC : S16 Ratio}}{\text{Total Number of DUOS customers in GB}}$$

According to the CIR the total connection charges levied in 2007/08 by DNOs across all voltage levels was £445Million.

If we enjoyed similar level of competition as the Gas Industry (53% penetration of CIC) the cost of this incentive would be:

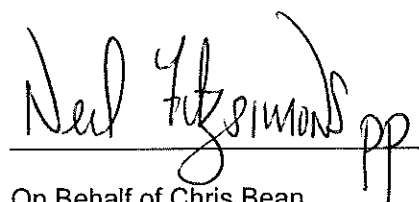
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$$\text{DUOS Burden} = \frac{\text{£}445.3\text{Million} \times 20\% \times 53\%}{28\text{ Million}} = \text{£}1.68^1$$

The cost of less than £2 per customer per annum to implement this proposal would seem comparatively small in proportion of the benefit to the industry in terms of promoting competition in connections, improving customer service and ultimately reducing connection costs.

We believe that implementation of the above measure within the DPCR5 period will in significant improvement in connections market which in turn will attract more entrants to the market place. We look forward to taking full part in the working groups developed to help OFGEM complete the DPCR5 process.

Yours Sincerely

A handwritten signature in black ink that reads "Neil Fitzsimons" followed by the initials "pp". The signature is written in a cursive style and is positioned above a horizontal line.

On Behalf of Chris Bean
Chairman of the MCCG

¹ The Figure of £28 million DUOS customers is taken from a 2001 Census showing the number of households in England and Wales to be £23.5 million and extrapolating for Scotland based on population to arrive at the £28million figure.