

Electricity Distribution Price Control Review

UPL Response to OFGEM

‘Initial Proposals’ Document Ref: 92/09 &

‘Initial Proposals – Incentives and Obligations’

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Prepared by:
Timothy Mortlock
Utility Partnership Limited
Prennau House
Copse Walk
Cardiff Gate Business Park
Cardiff
CF23 8XH
Tel – 02920 739591
Fax – 02920 739559
Email: tim.mortlock@up-ltd.co.uk
Web: www.up-ltd.co.uk

Contents

BACKGROUND 3

INITIAL PROPOSALS DOC REF 92/09 CONSULTATION RESPONSE..... 4

 CHAPTER TWO: BEHAVIOURS, INCENTIVES, FUNDS & OBLIGATIONS..... 4

 CHAPTER THREE PROPOSED ALLOWED REVENUES 5

 CHAPTER FOUR: RISKS & REWARDS..... 5

 UPL ADDITIONAL COMMENTS: 5

**INITIAL PROPOSALS – INCENTIVES & OBLIGATIONS DOC REF 93/09 CONSULTATION
RESPONSE 6**

 CHAPTER ONE: LOW CARBON NETWORKS FUND 6

 CHAPTER TWO: PROVISION OF INFORMATION TO DISTRIBUTED GENERATION..... 7

 CHAPTER THREE: DISTRIBUTED GENERATION INCENTIVE FRAMEWORK..... 8

 CHAPTER SIX: LOSSES INCENTIVE 8

 CHAPTER TEN: CONNECTIONS INCENTIVES AND OBLIGATIONS 8

Additional Areas Of Consideration..... 12

CONCLUSION..... 15

Background

UPL were formed in 1996 and since then have developed a broad client base, primarily consisting of major UK and international companies with large time sensitive capital and operational budgets, providing a wide variety of wholly independent utility consultancy services.

These services are primarily associated with:

- The design, wayleave and project management of the provision of utility connections to industrial, commercial, residential and embedded generation developments across the UK
- Utility infrastructure consultancy services for example relating to quality, cost and security of supply.
- Design, Infrastructure asset planning, wayleave, metering and project management services to the utility industry and the DNO's.
- Provision of energy management and smart metering services (we are an accredited meter operator), including energy cost and carbon footprint reduction

Through this work UPL have direct experience of provision of thousands of electricity connections per annum across the UK, and have a direct interest in electricity distribution issues, costs, quality and innovation.

In order to deliver our connections management we have tended to utilise the DNO's under their statutory obligation to provide new minor LV connections, although have been at the forefront of utilising competition in connections wherever possible should it deliver either cost, quality or service level benefits to our customers – particularly for larger schemes involving HV works. We have also been responsible for managing a variety of projects which have pushed the boundaries of competition, such as into on-site diversionary works. We therefore have a large amount of direct experience of competitive connections, whether they are installed by an ICP and adopted by the DNO, installed by an affiliated connections business and adopted by the DNO or installed and adopted by an IDNO.

UPL also manage the delivery of a large number of gas and water connections and infrastructure issues on behalf of our customers.

UPL is a totally independent company working on behalf of our customers. We provide representation on the Metered Connections Customer (User) Group (MCCG) and on the Electricity Connections Steering Group (ECSG) that contribute directly to OFGEM's promotion of competition in connections.

The views expressed within this document are solely UPL's, though we believe are supported by our major customers, with their significant requirement being for timely, secure and cost effective electricity supplies. We have only responded to those parts of the electricity Distribution Price Control Review 5 (DPCR5) 'Initial Proposals' (Doc Ref 92/09) and 'Initial Proposals – Incentives and Obligations' (Doc Ref 93/09) consultation documents that directly affect us and / or our customers or where we have a strong opinion and it would be fair to assume that we are broadly supportive of Ofgem's approach in any other areas we have not commented on.

Initial Proposals Doc Ref 92/09 Consultation Response

Ofgem Questions

Chapter Two: Behaviours, Incentives, Funds & Obligations

Question One Have We Introduced a set of measures that can be understood by customers and other stakeholders?

UPL Response: We consider Ofgem's proposals to be a broad but coherent attempt to encourage the DNO's to invest in their networks, improve statutory connections performance, increase competition in connections and to plan for the new type of distribution networks likely to be developed over the next 20 years due to the low carbon agenda. We therefore consider that the measures proposed to be introduced can be easily understood by all major stakeholders.

Question Two: Are we aiming to encourage the behaviour you consider appropriate for DNO's in the 2010 to 2015 period?

UPL Response: We are broadly supportive of the behaviours that Ofgem are seeking to encourage. However we believe that more emphasis should be put on the development / training of staff (apprenticeships) as we do not consider that the significant skills gap that exists within the industry will be addressed under the status quo. We also believe that more emphasis should be placed on the DNO's to be pro-active in managing capacity constraints on their network and in planning for load growth. We know of many situations where DNO's seem intent on letting the network operate outside or on the limit of its capacity / resilience availability, resulting in long-lead times and major reinforcement costs (even where apportioned) for developers who require new or additional capacity. For example we are aware of one DNO who had identified major network and capacity issues on one islanded area of its network which could only be resolved by large-scale 33kV and 132kV reinforcement. The DNO in question reported on this issue, identified the options available to it to complete the reinforcement and then chose to ignore the issue until government backed development and resultant connections demand funded the works. This lack of planning on the DNO's part has resulted in both the government backed and other local commercial development suffering major costs and lead-in times in an area with significant economic and unemployment issues. Three and a half years since the initial application the reinforcement is still some way off being even commenced. We believe this is an example of DNO's poor investment in their networks and long-term planning having had a major impact on local economic activity, and the DNO's must be encouraged to take a more pro-active role in preventing such issues, both in relation to their existing networks and the impact this has on import and export connections.

Question Three: Are the proposed mechanisms likely to be successful?

UPL Response: We comment further on the individual incentives and obligations being placed on the DNO's later in this document, but in general we are pleased to see mechanisms being imposed on the DNO's that are coherently linked to the

behaviours being encouraged, and which we believe will go some way to delivering these benefits for end customers. In particular we are pleased to see the much more robust approach Ofgem is taking to improving statutory connection service levels, and extending the market reach of competition in connections, as we have for many years considered this to be a significant regulatory failing.

Chapter Three Proposed Allowed Revenues

Chapter Four: Risks & Rewards

UPL Response: We broadly support Ofgem's approach in these areas. However as noted above we believe that whilst Ofgem have recognised the "need to reinforce specific parts of the network either to meet new demand that has already materialised and which places the network at full capacity, or to meet new demand expected for specific areas of the DNOs' networks over the DPCR5 period" (ch3 p.29) we do not believe enough emphasis is placed on this aspect. As noted above our experience is that DNOs wait for import / export connections requirements to generate reinforcement schemes rather than planning for and resolving such reinforcement issues in a pro-active manner. Not only does this place pressure on network performance but it is also a major impediment to economic development and the delivery of embedded generation.

UPL Additional Comments:

We consider that Ofgem should give some further consideration to DNO's structures. For example we still believe that some DNO's separation of connections and contracting businesses is a means to justifying the costs of regulated work, whilst the affiliated business undertakes the work on a sub-contract basis as unregulated income. We are also unsure of the benefits that would arise for customers should the number of DNO's be consolidated through merger / acquisition activity.

Initial Proposals – Incentives & Obligations Doc Ref 93/09 Consultation Response

Ofgem Questions

Chapter One: Low Carbon Networks Fund

Question 1: Do you agree with our proposals for a new mechanism to encourage DNOs to develop their role in the low carbon economy?

UPL Response: UPL are pleased to see the significant time and funding that is being allocated through the low carbon networks fund to encourage the DNO's to deliver, or at least to research and implement measures that may assist in delivering, a low carbon economy. However we are disappointed that whilst we recognise the funds aim is to implement trials on the DNO's networks the funding is only available directly to DNO's. We would prefer a mechanism that allowed for some of the funding (tier 2 - that which is to be subject to oversight and allocated by an Ofgem committee) to be open to applications from external companies. Under such an arrangement the Ofgem committee could hear applications from DNO's and external companies, and where external companies put forward beneficial proposals then we would expect Ofgem to facilitate the partnering process with appropriate DNO's. It is our view that left purely to their own devices then the DNO's proposals, and the partner companies they choose to work with, may be more limited.

Question 2: In particular do you agree with?

- i) The proposed size of the funding. **UPL Response:** We consider the funding to be considerable and sufficient for real flagship innovative trials to be undertaken which will enable the benefits of wider implementation to be assessed. As noted above, we believe further efforts should be made to widen this funding so that 3rd party companies can apply for innovative schemes to be implemented.
- ii) The proposals for discretionary rewards. **UPL Response:** the level of discretionary rewards seems excessive when compared to the size of the fund and some reweighting of this should be considered.
- iii) The two-tier structure? **UPL Response:** We agree with the two-tier structure, though as noted above believe tier 2 should in some form be available for external applicants to submit proposals.
- iv) The proposals to recover tier 2 costs over a five-year period? **UPL Response:** We agree with these proposals
- v) The measures to mitigate DNO risk? **UPL Response:** We believe these measures to be necessary to encourage the necessary innovative projects with their associated risk.

Question 5: Do you agree that the funding should be provided on a use it or lose it basis, and should the tier 2 funding be ramped over the period?

UPL Response: We support the proposals to ramp up the tier 2 funding over the period as the innovative proposals that will bring most benefit may take some time to develop. For the same reason we would encourage Ofgem to take a flexible view on

the use-it or lose-it basis of the funding as the focus should be on getting the projects right and deriving long-term learning benefit rather than to rush the spending through.

Question 6: Do you consider that this mechanism will achieve our stated objectives?

UPL Response: We believe this measure will go some way to achieving the benefits but think the Ofgem allocating committee will need to take a pro-active role in working with both DNO's and 3rd party organisations to ensure appropriate projects are identified and delivered, and to keep the proposals focused on the low carbon aims.

Chapter Two: Provision of information to Distributed Generation

Question 1: Have we correctly captured the customers information needs?

UPL Response: Our involvement is primarily with embedded generation developers wishing to connect generation at 11kV or above (i.e. not domestic type generation). We believe our customers needs with respect to information are reasonably accurate, though it should be emphasised that the more network capacity and loading information that can be made available the better. Whilst we understand DNO's reluctance from a bureaucracy point of view to publish all 11kV feeder load information, we believe this should be a long-term aim which the DNO's should be obliged to work towards. We also believe that as a minimum DNO's should be obliged to publish load, capacity and GIS network data for all primary substations, 33kV and 132kV network via the Internet.

Question 2: Do you agree with the scope of proposed licence obligations?

UPL Response: We agree with the scope of the proposed licence obligations in respect of provision of a DG connection guide, LTDS information (provided as noted above it includes technical information down to the primary substation level) and strategy for information provision. However we should point out that distribution generation developers concerns with respect to obtaining a connection relate not only to the information available to them, but also (like most developers) to the speed, quality and cost for the service from the DNO's. Whilst we are therefore pleased to see the new standards of performance that will be imposed on the DNO's with respect to connections performance in general, and for DG in particular, we are concerned that the level of resource within the DNO's who specialise in this area is limited. The increasing amount of DG that requires to be connected will place significant burdens on the DNO's to maintain current service levels, and the improvements required will only make this harder. The DNO's must be encouraged to invest in the necessary resource and systems to facilitate the connection of embedded generation and experience would suggest that the current incentives under the Distributed Generation incentive framework are not sufficient.

Question 3: Do you agree with our proposal to request DNOs to commit to a strategy for information provision?

UPL Response: As noted above we support this proposal though believe the level of information provided must include network information down to at least the primary substation level, with the aim of making 11kV network data available in the longer term. We would also recommend that DNO's be encouraged to provide information / work with distributed generators to encourage the connection of DG to areas of the network which would either benefit from it, or can accept such connection with minimal reinforcement works. The current separation between network considerations and the location / point of connection for DG is unhelpful in both increasing the amount of DG connected, and in improving the resilience of the distribution networks, and the DNO's should be encouraged to work pro-actively in this regard.

Chapter Three: Distributed Generation Incentive Framework

Question 1: Do you agree with our proposal to retain the DG incentive framework largely unchanged from DPCR4, and do you have any comments on the detail of our proposals?

UPL Response: We support the retention of the incentive, but would like to see it extended as our experience to date suggests that the DNO's have not implemented sufficient resource or network investment to facilitate the level of distributed generation connections required.

Chapter Six: Losses incentive

UPL Response: We support the retention of an output based approach to the losses incentive, the increased incentive and for the common method of losses reporting proposed to be introduced using unadjusted settlement data. We believe that only once smart metering is rolled out across the networks in parallel with smart grids technology to remotely monitor load on the network will the true level of losses be understood. However we believe it is correct that the DNOs should be incentivised to help improve such losses measurement rather than moving to the input based approach which would reward activity (such as the installation of low-loss equipment) which should be the norm.

Chapter Ten: Connections incentives and obligations

As an independent utility management consultant we have considerable experience over the past thirteen years of service levels from DNO's with respect to statutory connections and to their performance with regard to competitive connections and the resultant impacts on our customers and us.

The imposition of the proposed performance standards has been driven by complaints about the length of time DNOs take to complete connections work and we would summarise the major impediments we face in utilising competition in

connections to provide cost, quality and service level improvements to our customers as:

- DNO's failure to meet the service levels identified by OFGEM
- Inconsistency between DNO's in provision of non-contestable costs and their associated charges
- Lack of nationally agreed bilateral adoption agreements
- DNO's acquisition of legal consents delaying energisation of network extensions
- Some DNO's lack of separation between their asset and connection businesses and / or providing unfair advantages to their affiliated connection businesses
- Restrictive and costly design approval and inspection charges / regimes
- DNO's requirement for boundary metering and isolation (IDNO schemes)
- DNO's only applying 2nd comer rule to licensed schemes
- Inconsistent application of apportionment rules for reinforcement and in some cases DNO's refusing to contribute towards such reinforcement
- Inconsistent application of O&M charges
- Restrictions on contestable activities
- Additional costs associated with competition e.g. inspection charges
- Level of statutory connections costs in market segments not realistically open to the competitive market place (one-off sub 100amp LV connections)

It is our experience that DNO's willingness, their processes and structural ability to facilitate competition in connections vary by significant margins, as do the associated costs and service levels. We therefore welcome OFGEM's proposals as a significant step towards a real enabling of competition in electricity connections – the primary reason for which is to deliver price and quality of service benefits for end customers in an area which continues for many to be a source of frustration and high price.

However we would point out that Ofgem's proposals do not address some of our concerns, for example the varied application of apportioned reinforcement charges, application of the 2nd comer rule and the restriction on the extent of contestable works (particularly not allowing ICP's to identify the point of connection or perform the final connection).

Question 1: Do you agree with the scope, timeframes and the level of penalties proposed for the guaranteed standards regime?

UPL Response: We broadly support the scope timeframes and level of penalties proposed. We would point out that for non-domestic customers (such as UPL) the penalties on a DNO are no compensation for the costs and delays that we and our customers incur as a result of poor performance, and we support them because of the incentivising implications we believe they should have on the DNO's. i.e. the level of penalty is irrelevant compared to the simple need for the DNO to make such a payment. With respect to the scope of the penalties, we are pleased that the standard are not only for provision of quotations but relate to the whole-life delivery of a connection, but would point out that after acceptance of a quotation the DNO's will often require wayleaves / legals to be dealt with prior to provision of a works date. This can be a black hole into which many schemes fall, and which can be used as an

excuse for delays in delivery. The proposed standards do not deal with such issues, and we believe that the standards post-acceptance of quotations should be modified to ensure that wayleave requirements are progressed in a timely manner.

Question 2: Should we develop a mechanism to ramp up the level of the proposed penalty payments?

UPL Response: We believe the penalties proposed, which include for their continuation for each day that the failure continues to be sufficient and see no particular need for the penalties to be ramped up. As noted above we consider the imposition of an increasing penalty in itself to be more important than the financial impact it has on the DNO.

Question 3: Should we cap the penalties that apply to each of the proposed standards?

UPL Response: We do not believe the penalties should be capped as they are simply related to the length of delay incurred by the customer, and if capped would not incentivise (or rather penalise) the DNO further for continuing delays post initial failure to meet the required service standards

Question 4: Should we apply in aggregate a 90% performance target to apply to the standards and measure this on a quarterly basis?

UPL Response: We believe such a target should be applied. As has been recognised in the Ofgem proposals, the DNO's systems are currently inadequate to monitor their own performance against the proposed standards. We also believe the resources and processes they internally operate will prevent many of these standards being met. We therefore believe that many DNO's will not succeed in meeting the standards on day one of the DPCR5 period and therefore that whilst this target should be imposed, the DNO's should be encouraged to report accurately and to improve their performance to meet this target. An admission of failure to meet the target, provided it is followed with genuine improvements is preferred to the fudging of figures which is our historic experience of, for example, quotation turnaround timescales.

Question 5: Do you agree with our market segmentation strategy for metered and unmetered connections? Are there any segments other than those identified that should be exempt from earning a margin?

UPL Response: Our primary concern is that the DNO's should only be allowed to apply margin where competition in connection has already been shown to exist (not just with affiliated companies), and in market segments which are in a position to benefit from competition. We agree in general with the market segmentation proposed, however still have concerns regarding customers who require "minor" LV connections and those connections involving HV overhead works. With respect to "minor" LV connections the level of contestable works can often be small, and even for customers who have a large volume of such connections, the mobilisation costs are prohibitive given the level of the non-contestable costs involved and the importance of the final energisation. Only if the determination of the point of

connection, design approval and final energisation of such minor LV connection were made contestable in a similar manner to the gas industry would this market segment truly be open to competition. We support therefore the proposal to remove “one-off industrial and commercial single or three phase connection upto 60kVA” from the application of contestable margin, however would ask that the definition of “Other LV with only LV work” which is to be allowed margin be clarified to ensure that no sub-60kVA standalone connections can be included in it. With respect to connections involving HV works, it is our experience that there are very few, if any, ICP’s accredited for and actually active in undertaking connections involving HV overhead works (either overhead network extensions, installation of pole mounted transformers, or even connection to pole mounted transformers). We would therefore also recommend that such schemes be moved into a separate market segment, to protect this market from the imposition of further costs with no realistic opportunity to benefit from the competitive market.

Question 6: What are your views on the proposed level of regulated margin and is there any further evidence we should take into account in setting the level of regulated margin?

UPL Response: We support the proposed level of regulated margin (4%), though would point out there is great scepticism in the marketplace regarding the DNO’s level of costs currently quoted and the amount of mark-up included within such costs. Whilst we support the introduction of regulated margin in certain market sectors where real competition exists, we would point out that the purpose of competition is to improve costs and service levels for the end customer. The DNO’s price is currently seen as a benchmark which the ICP’s must beat to be competitive (i.e. ICP’s currently tend to compete against a DNO price rather than against each other). The higher the DNO price then the higher the benchmark and the higher the ICP’s price will be unless a real competitive market is created which itself drives the price down.

Question 7: Do you have any comments on the proposed competition tests?

UPL Response: We support the proposed competition tests, though are concerned about DNO’s ability to claim regulated margins in advance of competition tests being met. We do not consider the current claw back mechanism proposals where the tests are not met by December 2013 to be adequate. The regulated margin will be funded by customers requiring connections in DNO areas which may either never, or not at that point in time, be subject to a truly competitive market. The suggestion that this margin could be refunded to the customer in the future post 2013 is extremely unrealistic. We do not believe the DNO’s should therefore be able to charge any regulated margin either until they have met all, or at least some, of the competition tests.

Question 8: We invite views on the relative weighting of market share compared to the price and service tests? What level of lost market share would be appropriate to deem the market competitive?

UPL Response: We believe the gas market sets the standard for such tests, at least in the metered connections market, where only 42% were installed by the incumbent

utility or one of their affiliates (CIR 2007-08). However we also realise that the electricity market is a long way from this position and would at this stage suggest an 80% market share by the DNO's would represent a competitive marketplace.

Additional Areas Of Consideration

We believe Ofgem should consider the following areas for action with respect to the connections marketplace.

2nd Comer Rule

UPL has direct experience where DNO's are clearly refusing to apply the 2nd comer rule in cases where an ICP has installed a network extension. This means that, for example, should a developer pay an ICP to install new assets from which other developers in the area and the DNO benefit then **no reimbursement** of apportioned costs is made.

However should the same developer pay a DNO to install new assets under a licensed section 16 quotation and other developers in the area benefit then reimbursement is paid to the first comer developer.

This provides a significant disincentive for end users to utilise competition in connections as they will be financially penalised if other parties benefit from the assets they are paying to install. Furthermore it would be misleading of ICP's to not inform a customer of this possible future reimbursement.

UPL have been involved in a number of schemes of over £2M value where this issue has provided a major reason for proceeding with a licensed DNO scheme and not using competition in connections.

UPL therefore recommend that OFGEM act within the current proposals to ensure the 2nd comer rule applies to both adopted/ licensed and CinC connections.

Apportionment Rule

In 2004 the rules with respect to customer / DNO contributions to reinforcement were changed. The old '25% rule' was inequitable, as it meant that either the DNO or the end customer paid the full cost of reinforcement.

The new apportionment rule, meaning that developers contribute to network reinforcement on a proportional basis to their capacity requirement is clearly a more equitable and reasonable mechanism for such costs to be separated.

However UPL have direct experience of a number of DNO's treating almost all connections works as "network extensions", requiring new infrastructure which they will then adopt being wholly chargeable to the end customer. In many cases we believe such works should have been treated as network reinforcement, undertaken by the DNO as a non-contestable activity and charged on an apportionment basis to the end customer.

By such means some DNO's are simply not contributing to reinforcement of their own network, and indeed are leaving it to developers requests and financial contributions to make up for a lack of investment in their own networks.

This situation is only made worse for the end users when the 2nd comer issues already highlighted are taken into account. In such circumstances the DNO treats all connections works as new infrastructure with no apportionment of costs, and yet if 2nd comers benefit from an ICP installation of such infrastructure then the first user is penalised.

This issue provides a further significant impediment to competition in connections, in addition to increasing connections costs for developers and removing incentives for DNO's to invest in the development and security of their own networks.

We therefore recommend that Ofgem acts to ensure all DNO's apply the apportionment rules fairly such that they contribute to infrastructure improvements from which their network assets benefit.

Wayleaves / Legal Consents

The provision of legal consents for the placing and future maintaining of DNO electricity lines and apparatus currently required to provide energisation of an ICP network to be adopted, or indeed to enable an IDNO connection is a further significant factor that is adversely influencing and delaying the connection process and thereby inhibiting competition in connections. This issue however has not been considered in any significant way either in this Ofgem proposals document or in previous reviews of competition in connections.

These "wayleave" issues can delay energisation of ICP network extensions and / or IDNO embedded networks by many months, and lead to frustration on the part of developers who having appointed an ICP / IDNO still have to liaise in many cases with the host DNO's estates business.

Whilst it is accepted that the process of acquiring legal consents will not be completely standard for all sites, it is possible to establish a standard process that will be appropriate to the majority of sites and for all DNOs to make such consent acquisition "contestable". The small number of sites where the acquisition of legal consents cannot conform to the norm will require individual negotiations, but over time these anomalous sites will also fall into a pattern, thereby allowing the adoption of a standard approach to the acquisition process.

We recommend that:

- 1) All DNO's to publish their: -
 - standard terms and conditions,
 - legal fees
 - template legal agreements
 - Requirement for legal drawings

- 2) ICP's / IDNO's to be able to prepare and procure legal agreements over proposed DNO apparatus i.e. for wayleaves to be a contestable item
- 3) DNO only to obtain legal agreements directly where rights are required from 3rd party land owners over whom the ICP / IDNO have no influence

Conclusion

UPL believe that OFGEM's DPCR5 initial proposals document(s) provides a significant step towards a transparent and competitive electricity connections marketplace, and to ensure a safe and reliable distribution network whilst reducing the environmental impact of such distribution.

Where we have not responded directly to Ofgems proposals documents then we are therefore broadly supportive of the aims and mechanisms contained, and have only responded in those areas where we have strong opinions either in support of or in contrast to Ofgem's proposals.