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Date: 18 July 2011

Dear Donald,

Consultation response: Competition for part-funded connections work

CE Electric UK Funding Company (CE) is the UK parent company of Northern Electric Distribution Ltd (NEDL) and Yorkshire Electricity Distribution plc (YEDL).

We are writing to enclose our response to the above consultation, which invites DNOs, ICPs and IDNOs to develop and bring forward proposals to introduce a mechanism via which price-control revenue can be made available to ICPs where they construct connections that would be part-funded if constructed by a DNO, and to consider the possibility of allowing IDNOs to adopt part-funded connection assets. The detailed answers to Ofgem's specific questions in the consultation are shown in the appendix to this letter.

The consultation, and the independents viewpoint, raises a number of issues and we welcome further details and scenarios that are envisaged in order to provide clarity on which aspect of the current arrangements would need to change.

I hope you find our comments and answers to your questions helpful, and if you would like further clarification of any aspects of our response, please contact me so that we can arrange to discuss these.

Yours sincerely

Harvey Jones

Head of Network Trading

CE ELECTRIC UK FUNDING COMPANY

Registered Office: Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF
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Appendix 1 – Competition for part-funded connections work

How much work would become contestable?

Question 1: We welcome respondents' views as to the total value and proportion of part-funded work that would be deemed contestable in the case that the methodology is modified to make clear that connections work may be contestable where it is funded by more than one party.

Answer: The consultation states that "it is likely that some of this work will be non-contestable for other reasons, so will not be open to competition even if price-control revenue is made available to ICPs. For example, reinforcement work that is not electrically separate from the existing distribution system is generally non-contestable."

It is also worth highlighting that the RIIO guidance states:

"13.8 We will consider giving third parties a greater role in delivery where the following conditions apply:

- The project is significant in scale and/or cost;
- The project involves assets required for expansion of the network that are not meshed with existing assets, or can be defined in such a way that they are not meshed with existing assets; .."

We believe the two items together suggest that the level of work that can be undertaken by an ICP or IDNO is very small as it will be only those elements that are on the boundary of our network and electrically separate that can be undertaken by a third party.

The element of connections capital expenditure funded by the DPCR5 price-control was forecast at £410.1m for all DNOs and the consultation indicates that c. £820m of total connections work will be part-funded. The £820m is based on an Ofgem-assumed apportionment factor of 50% and, given that only reinforcement work that is electrically separate is likely to become contestable, this implies a much larger contestable market compared with what could be expected in reality. We agree with Ofgem's comments in the consultation that some of this work will be non-contestable for other reasons and is likely to only cover those reinforcement aspects that are electrically separate from the existing distribution system.

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Question 2: Do respondents consider that further changes to the rules surrounding contestability should be made in tandem with any move to introduce competition for part-funded connections and, if so, what affect would this have on question 1?

Answer: We are generally supportive of efforts to extend contestability and promote competition and are happy to be involved in any specific discussion in this area. Effective competition will also be driven by a desire for market participants to actually compete to carry out the work.

How should payments to ICPs be calculated and made?

Question 3: We welcome respondents' views on whether arrangements should be established under which DNOs would make price-control money available to ICPs, and how the amount of money should be calculated.

Answer: In relation to the calculation of a DNO's contribution our initial view is that option 3 may be the preferred option as this would lead to efficiency savings for the end customers. However, we perceive that options 2 and 3 would involve the DNO obtaining information about the ICP costs, which may not be acceptable for competition act reasons. All of the options require further detailed consideration in order to ensure that there are no unintended consequences for customers in general and on distribution price-control arrangements.

Question 4: We welcome respondents' views on any commercial issues that might arise if DNOs provided such payments to ICPs. For example, the timing of payment(s) and risks associated with an ICP being unable to complete a project.

Answer: A DNO has no obligation to adopt assets constructed by an ICP and as such the DNO has no liability during the construction phase. We believe that payment should be made upon satisfactory completion and adoption of the relevant assets in order to minimise the liability on the DNO and funding risks for customers in general including protection against an ICP or end-customer default situations. We have examples of both ICPs and end customers, who have employed ICPs, asking us to complete the contestable elements of a project and as such there is therefore no guarantee that reinforcement work to be undertaken by an ICP will be completed.

One of the key points of this proposal is that the DNO would pay an ICP, appointed by the end customer, a sum of money at some point. Where the value of a project, or series of projects, exceeds a certain spend level EU procurement legislation will need to be adhered to and Ofgem will need to consider how this will impact on these proposals.

Should the proportion of work funded by the DNO affect contestability?

Question 5: We welcome respondents' views in respect of whether the percentage of costs borne by the DNO should affect whether the part-funded work is considered to be contestable.

Answer: We understand the proposals for a "50% rule" were never finalised by the ECSG subgroup tasked with delivering the report: however, it would seem logical that if the DNO, on behalf of customers in general, is providing the majority of the funding then the DNO should have the majority decision powers over who completes the work. This should not preclude the DNO from employing the ICP under contract to complete the work.

Should margins be applied to part-funded connections?

Question 6: Do respondents consider that DNOs should be allowed to earn a margin on contestable part-funded connections?

Answer: We believe that DNOs should be able to earn a margin on the element of work that would be contestable and funded directly by the connecting customer. However, we would recommend that the element initially funded by the DNO does not attract a margin to ensure that the DNO does not earn a return twice, i.e. DNOs currently earn a return on costs that are allocated to RAV, so that allowing a margin on these elements would result in DNOs earning margins from two different sources.

Question 7: Do respondents consider that the margin should be applied to the whole connection or restricted to the customer-funded element of the connection?

Answer: As highlighted in the answer to question 6 we believe the margin should be restricted to the customer-funded element of the connection.

How will part-funded work enter the RAV?

Question 8: We welcome respondents' views as to whether the introduction of competition would have any effect in respect of the RAV.

Answer: There are three key items that Ofgem needs to consider to ensure that the introduction of competition will not have any effect on RAV:

1. A margin should not be allowed to be charged on the element of connections that is allocated to RAV;

2. The element of the connection that is chargeable to the DNO should be the lower of the total amount that the DNO would have contributed had it carried out the work or the ICP's net costs after customer contribution to ensure the best deal for customers; and
3. In the DPCR5 period Ofgem has provided allowances of £26m for CE in relation to part-funded connections. As part of the settlement these allowances are subject to a true-up dependent on actual volumes and customer contributions. If this proposal is put into effect during DPCR5, and ICPs win the work, then this will impact on those volumes and contribution, so Ofgem will need to ensure that DNOs are not penalised in terms of costs being deemed inefficient as a result of this policy.

Should IDNOs be able to adopt part-funded assets?

Question 9: We welcome respondents' views on whether and, if so, under what circumstances, IDNOs should be able to adopt part-funded network assets.

Answer: We need to consider the impact of IDNOs owning pockets of our network, who will be responsible for loss of supply due to failure of assets owned by IDNOs and the impact on charging DUoS where the RAV is not fully recovered. The funding of reinforcement by DNO's should only create benefits for customers in general and not create inadvertent subsidies for IDNO networks. We would need scenarios from both independents and Ofgem in order to understand this concept fully.

We need clearly to distinguish between the roles of ICPs and IDNOs, and understand that a given party can be both ICP and IDNO on the same customer-driven project.

On this basis, a given "independent" operator can:

- a) Build, own and operate connection assets dedicated to the relevant customer/property developer, downstream of the agreed point of connection, as a licensed IDNO; and
- b) Build and transfer (to the "host" licensee) reinforcement assets to service new, existing and likely future customers, upstream of the agreed point of supply, as an accredited ICP.

Ownership arrangements, and therefore responsibility for the safety and security of supply, are clear. Similarly, commercial arrangements are clear, as:

- a) The host licensee will pay an appropriate sum to the independent operator to adopt the reinforcement assets, as for any other ICP; and

- b) The host licensee will charge the downstream IDNO in accordance with CDCM, covering all the services of providing and maintaining upstream assets.

However, allowing IDNOs to adopt assets that have been installed and may be deeply embedded in another licensee's network is unworkable from safety, security, and commercial aspects. In practice, this argument appears to collapse to the point where the only workable solution is that incumbents (including IDNOs downstream of the point of connection) own and operate reinforcement assets and independents can own and operate new connection assets.

Regulatory arrangements

Question 10: Do respondents consider there is any reason why such provisions cannot be included within the current regulatory arrangements?

Answer: At this time it is difficult to see how these concepts could be accommodated within the current regulatory arrangements until the appropriate detail are clearer.

Question 11: We welcome respondents' views on the appropriate nature and location of such provisions.

Answer: At this time it is difficult to see how this can be accommodated within the current regulatory arrangements until the appropriate detail has been finalised.

Dispute resolution

Question 12: We welcome respondents' views on the need for and the appropriate nature of a dispute resolution process.

Answer: CE has a well established dispute resolution process, which allows escalation of any complaint to the appropriate level within the company and recognises the customers' right to seek redress from Ofgem or the Ombudsman.

Further comments

Question 13: Do respondents have any views on any issues not covered above?

Answer: We would also suggest that Ofgem also needs to consider what happens if there is a loss of supply during the construction and the liability for the financial penalties CI/CML targets/results. Furthermore what will happen if the ICP or end customer enters a default situation such as liquidation, bankruptcy or receivership?

We would also like to point out that when a DNO adopts assets from an ICP there is no additional revenue generated as the adopted assets have no impact on the DNO's RAV.

Under the current competition arrangements the customer appoints the ICP and the DNO adopts the newly constructed assets from the assets owner, typically the ICP. Under the new proposals the customer would appoint the ICP however, it is proposed the DNO would pay a proportion of the reinforcement costs to that ICP. This would lead to a tripartite relationship whereby the customer would be liable for the reinforcement costs or completion of the works in the event of a default on behalf of the ICP. This would be necessary to minimise any risk to customers in general, therefore consideration need to be given to the nature of the contracts that would need to be in place between all the parties.