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Dear Donald

Competition for part funded connections work

In response to your consultation of 1 June 2011 we would make the following comments.

We support the principle that part funding in itself should not determine that the reinforcement work is non-contestable. As Ofgem acknowledges, there are other reasons why some reinforcement work would in our view remain non-contestable. These include where the assets are not physically and electrically separate, access to existing operational areas is required, installation of overhead lines and cables exceeding 33kV.

There are a number of issues that need to be considered to allow workable mechanisms to be developed. Some of these will need policy direction from Ofgem to allow these to be progressed. The balance between creating an environment to support the development of competition and protecting the interests of DUoS customers will need careful consideration by Ofgem. Clarity on this perspective is essential to allow a considered evaluation of different payment methods for example. We have expanded on this point and answered the specific questions raised in your consultation in an appendix.

We are happy to commit to engaging constructively with Ofgem and other industry stakeholders to develop a workable process that supports these principles. However, we do believe that Ofgem needs to consider the wider context of connections reinforcement. DNOs are incentivised to find innovative ways to reduce the need for the installation of bigger assets as the solution to all reinforcement issues. Electricity connections are often compared unfavourably to those of gas and an important explanatory factor may be how reinforcement is dealt with. We believe that many of the processes that exist in gas are facilitated by the fact that, in the majority of cases, network reinforcement is not charged to the connecting customer. We believe that Ofgem should consider a fundamental review of the charging for connections reinforcement so that any changes can be incorporated into your RIIO considerations.

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

Yours sincerely,

Brian Hoy
Head of Market Regulation

APPENDIX

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?*

At this stage it is difficult to assess the proportion of work that would be deemed contestable as the criteria are not yet established to even allow an historic assessment to be carried out.

Ofgem needs to clarify the scope of what work would be considered contestable and non-contestable. Currently there are a number of other criteria that would make the work non-contestable, eg physically and electrically separate, no access to existing operational areas required, installation of overhead lines and cables not exceeding 33kV and clarity is required whether these still apply to part funded reinforcement.

However, to provide an input to the consultation, we have analysed a small sample of projects to give some indication of the proportion of reinforcement work that would be electrically separate. In our sample, for grid and primary voltages, around 30% of the reinforcement work was electrically separate and for secondary networks this rose to around 50%.

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?*

Two workstreams have been agreed at the Electricity Connections Steering Group to look at extending contestability to closing joints to the existing network (through live connections to existing mains for low voltage) and to ICPs and IDNOs determining their own points of connections. These, taken with the intent of this consultation, means that there are limited aspects of the process of making a connection that remain non-contestable. Whilst it is possible that process improvements may apply to these remaining activities, it is difficult to see how these could become contestable. We have used the table of activities, developed as part of establishing the Common Connections Charging Methodology, to comment on each of the activities that are currently non-contestable.

Ref	Activity	Contestable/ Non-Contestable	Comment
1	Determine POC to Distribution System	Non Contestable	Workstream agreed to review feasibility of ICPs & IDNOs determining their own POC
2	Design of Extension Assets	Contestable	Already contestable
3	Design upstream Reinforcement works associated with new connections.	Non Contestable	Needs to be retained by DNO to ensure other obligations (P2/6 etc) are met
4	Design diversionary works associated with new connections	Contestable	Already contestable
5	Design approval	Non Contestable	May be opportunity to streamline but ultimately the party adopting needs to approve the design
6	Plant and materials specifications	Non Contestable	May be opportunity to streamline but ultimately the party adopting needs to govern the specification

Ref	Activity	Contestable/ Non- Contestable	Comment
7	Procure materials for own works	Contestable	Already contestable
8	Land Rights negotiations with third party landowners	Contestable	Already contestable
9	Produce wayleave/easement documentation and enter into agreements with third party landowners	Non Contestable	May be opportunity to streamline but the party adopting needs to enter into the agreements
10	Trench excavation and duct installation – on site	Contestable	Already contestable
11	Trench excavation and duct installation – on public highway	Contestable	Already contestable
12	Construction of substation buildings and other civil works – on site	Contestable	Already contestable
13	Cable laying for own works	Contestable	Already contestable
14	Substation plant installation for own works	Contestable	Already contestable
15	Excavation for jointing bay – on site	Contestable	Already contestable
16	Excavation for own works jointing bay – public highway	Contestable	Already contestable
17	Jointing (dead) of cables within Extension Assets	Contestable	Already contestable
18	Jointing (live) to connect Contestable Works to Distribution System (closing joints)	Non Contestable	Workstream established and trials being conducted
19	Excavation for joints to connect Contestable Works to Distribution System (closing joints)	Contestable	Already contestable
20	Live LV jointing on newly adopted New Extension Assets ¹	Contestable	Already contestable
21	Reinforcement/diversionary work on the existing Distribution System	Non Contestable	Already contestable if sole funded and this consultation deals with part funded
22	Quality assurance inspections	Non Contestable	May be opportunity to streamline but the party adopting needs to have ability to verify quality of assets being installed
23	Testing of Extension Assets installed by ICP	Contestable	Already contestable
24	Commissioning and connection of Extension Assets to the Distribution System	Non Contestable	Workstream established and trials being conducted
25	Recording of installed assets	Contestable	Already contestable
26	Operations, repairs and maintenance	Non Contestable	Ongoing responsibility of the asset owner

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.*

We agree with Ofgem's view that payments would need to be made to ICPs by DNOs, however there are a number of issues that would need clarification.

In order to develop such mechanisms, there are some principles that need to be established. Primarily these relate to which party will select who will carry out the work and which of the parties carries the risk and reward. Parties that need to be considered are

- The customer requiring the connection that necessitates some part funded reinforcement
- The various ICPs that are tendering for the work
- The DNO both as a possible provider of the work but also as the provider of the non-contestable work
- DUoS customers who are in effect funding the "DNO contribution"

Considering each of the three options identified by Ofgem:

- i. Whilst this has the benefit of simplicity, it results in any cost savings that may occur from the ICP carrying out the work being retained by the ICP or possibly shared with the customer. Whilst DUoS customers are not disadvantaged by this approach, they do not see any potential cost benefits; Ofgem would need to verify that such costs are not considered inefficient investment and would go into the RAV.
- ii. This option would require clarity as to which party was actually making the decision as to who was going to construct the assets and whether it was always the same party that was carrying out the contestable network extension assets. In this option DUoS customers do get the benefit if the ICP costs are lower and would symmetrically bear more costs if they are higher. As ICPs are not subject to having to report costs under RRP, this could create an incentive for ICPs to "allocate" more of their costs to the reinforcement aspects of the work and thereby minimize the contribution by the customer but with DUoS customers being disadvantaged.
- iii. This option appears to provide a reasonable degree of protection for DUoS customers as they would never be any worse off than had the DNO carried out the work.

All three options may require that information is shared between parties that may be considered commercially sensitive.

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.*

The following comments are based on the assumption that the Customer is making the selection of who is undertaking the reinforcement work. Our view is that any payment to an ICP would need to be based on a fixed priced submission. This prevents the DNO and therefore DUoS customers being exposed to "low initial tender" bidding strategies. Variations for significant changes of scope in the reinforcement work may be considered but would require any design changes being revalidated by the DNO. Payment should be on completion with the possibility of phased payments for larger jobs.

Consideration needs to be given to the situation where the reinforcement is required for other reasons and not just that there is consequential extra capacity as a result of the work. There are situations where the costs of the reinforcement are being shared by more than one customer and clarity as to which customer decides on the party to do the work would be required. In other situations the work may be required to solve other reinforcement issues eg to meet P2/6 obligations. In those situations it would not be appropriate for the timing of the works to be

dictated solely by the Customers requirements and the DNO exposed to other risks. The commercial arrangements would need provision for the DNO to terminate the agreement if there were undue delays.

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?*

Again the response to this question is influenced by who is deciding on the constructing party for the reinforcement work. Where the proportion funded by the customer is very small it does seem odd that the customer can dictate the delivery provider. Whilst the threshold may need to be lower than 50%, it seems unreasonable that where the customer is only funding a small proportion of the work they should determine which party does it.

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

We consider that exactly the same principles of regulated and unregulated margin should apply. Ofgem need to apply this principle across all contestable work on a consistent basis.

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?*

We consider that margin should be applied to the whole connection. To not apply it to the whole connection would not create the sufficient incentive and "headroom" to attract new entrant to the market in line with Ofgem's policy position in Final Proposals¹.

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

Any money paid to ICPs should enter the RAV in the same manner as if the DNO had carried out the work. A separate mechanism may be required to manage margins. Clarity will also be required where the reinforcement is associated with distributed generation as this where the DNO had carried out the work this would be dealt with under the Distributed Generation (DG) Incentive rather than the RAV.

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

An IDNO who is adopting an asset should also be able to part fund it. In fact, this has been a feature of the market with IDNOs offering adoption payments. It is not appropriate for DNOs to provide funding to IDNOs for these assets. IDNOs receive funding for these assets through use of system charges.

¹ Section 12.4 of Final Proposals – Incentives and Obligations

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

It is difficult to comment when the mechanism is as yet unclear. That said, though changes would be required, we consider that the documents identified by Ofgem should allow a mechanism to be developed.

Depending on the value of the reinforcement, there may be European procurement issues that need consideration.

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

We would envisage that the introduction of these mechanisms would require changes to:

- Common Connections Charging Methodology
- The Distribution Licence – CRC 11 may need changes to deal with the DG Incentive treatment; CRC 12 would need changes if margin as to be allowed for DNOs
- RIGs for RRP.

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

It is difficult to comment when the mechanism is as yet unclear. The need for dispute resolution (other than an Ofgem determination) will vary based on the details of the mechanism.

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

Before considering whether to extend competition in this way, Ofgem needs to consider the appropriateness of the current connection boundary in respect of charging for a proportion of reinforcement of the existing distribution system. As new approaches to reinforcement are developed such as demand side response, the current approaches to charging will become less appropriate as reinforcement may be resolved by ongoing payments to customers/ aggregators rather through the construction of new assets. Extending competition to ICPs may inadvertently inhibit these important long term development.