

18 July 2011

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Dear Donald,

Response to Ofgem letter "Competition for part funded connections work: consultation document"

We have already made Ofgem aware of specific issues and how part funding of the elements of connection works can distort, restrict and prevent competition. We do not cover those points again in this letter.

Our response to Ofgem's questions is provided in an annex to this letter. In summary, we think:

- The scope for contestable works should be extended.
- That where the DNO funds elements of connection works through its price control revenues, the DNO should provide the same level of funding to an ICP where it undertakes the works.
- That for specific circumstances, it is appropriate that IDNOs could adopt part funded connection works.
- The basis for calculating the funding should be published in relevant connection charging statements.
- That subject to satisfying relevant competition tests, DNOs should be entitled to earn a margin on connection works that are part funded.

If you would like to discuss our views in more detail please contact me.

Yours sincerely

Mike Harding
Head of Regulation
GTC

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?

We are unable to quantify the value and proportion of part funded work that would be deemed contestable.

However, as Ofgem is aware, we have specific experience where part funding of the framework has threatened to restrict, distort or prevent competition. Such distortions are likely to occur where new assets are established to service existing and future network requirements (other than those of the customer).

Current examples of this are the establishment of new substations (as opposed to upgrading existing ones), or the laying of cables with a larger capacity than that required by the new development.

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?

We think changes to the rules surrounding contestability should be made to increase the nature and type of works that can be undertaken under the scope of contestable works.

We understand that licensees need to ensure that the integrity of their distribution system and the security of electricity supplies is maintained. Therefore, in extending contestability, we recognise that it may be necessary to have arrangements in place for ICPs and IDNOs to demonstrate relevant competencies through accreditations. Where they have relevant competencies and accreditations processes should be in place to facilitate and co-ordinate ICP/DNO undertaking activities, – in the same way that DNOs' own operational staff co-ordinate activities with the their own connections staff.

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.

Arrangements should be established under which DNOs make price control money available to ICPs/ IDNOs. Payments for the part funding of connection works undertaken by ICPs/IDNOs should be calculated on the same basis as the DNO would do if it were undertaking the same works:

- (i) For a Minimum Scheme, the level of funding will be determined by apportioning relevant costs on the basis of capacity in accordance with the relevant connection charging methodology.
- (ii) In some circumstances a DNO may require an ICP/ IDNO to undertake works which are in excess of the requirements of a minimum scheme. This may be where a DNO (in meeting its obligations to operate a co-ordinated, efficient and

economic distribution system) may require additional work to reinforce or reconfigure its network for future network requirements. The rules for calculating such funding should be clear and not result in different funding arrangements where the ICP/IDNO undertakes the works compared to where the DNO undertakes the works.

We think the DNOs' estimated costs of the connection works should be used as the benchmark to calculate the amounts to be paid as part funding for connection works.

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 commercial rules for making such payments should be clearly set out in a transparent manner to avoid ambiguity. Such rules should be documented in the Connection Charging Methodology Statement.

For ICPs/IDNOs undertaking contestable works, the timing of payment for funding should immediately follow (for example within 28 days) of the completion, acceptance and adoption by the DNO of the relevant connection works, with such completion not being unreasonable delayed.

We believe commercial issues may arise where:

- the adoption of, or the adoption date is disputed.
- the payment made to the ICP/IDNO is disputed. This is most likely to happen where the DNOs' assessment of costs, and therefore the amount offered for payment are alleged to be lower than the costs that the DNO would incur if doing the work.
- DNOs' requirements for contestable works being different depending on whether the ICP/IDNO or DNOs' own connection businesses undertake the work.

We do not think it is appropriate for payment of such funds to be withheld as a warranty in respect of part funded works. Issues around warranty are separate from part funding.

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?

In a market where the DNOs' own connection businesses compete with ICPs, we do not think it is tenable that the contestability of certain works should be prevented because of the level of subsidy provided by DNOs' upstream businesses through price control revenues is higher than a notional percentage.

To allow such practices distorts, restricts and prevents competition.

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

Yes, subject to such work being open to competition and subject to DNOs satisfying relevant competition tests. An efficient ICP (or an efficient DNOs' connections business) should be entitled to recover the efficient costs of undertaking and make a normal margin.

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?

The margin should apply to the whole connection. The part funding element should be applied to the gross costs (total net costs plus marginal). If the DNO was to subcontract works then the subcontractor would earn a margin, it therefore seems reasonable that an ICP undertaking works should be entitled to the same margin.

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

We do not think this should impact significantly on the RAV. The principle being put forward here is that the ICP should receive the same level of funding for works that the DNOs own connection business would receive if it undertook the works. We do not believe it is reasonable that an ICP (or customer) should be required to provide and fund assets which provide wider benefits to the distributor and for which the ICP receives no recompense.

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

Part funding of connection works may relate to the upgrading the existing network, for example:

- replacing an existing substation with a substation with a higher capacity,
- overlaying part of the existing distribution system with cables of a larger size.

Where the part funding relates to work that is "embedded" in the DNOs existing distribution system they should not be open to the IDNO for adoption.

However, there are circumstances where the part funding will relate to new assets provided as an addition or extension to the existing network. This may be where new substations and infrastructure are provided for future development. In such circumstances we see no reason why an IDNO shouldn't own and operate the assets, on the basis that it could provide future needs for the DNO. This could be, for example, where a connection requires the provision of a new substation, and where the installation of a substation off a larger capacity could provide capacity for a DNOs future network needs.

Separate to this consultation we have provided Ofgem with a specific set of circumstances where this was the case.

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

Competition in Connections framework is currently embodied within electricity distribution licences and DNO's connection charging methodologies. We think part funding can be covered in a similar way.

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

See our response to question 10. Notwithstanding that response, we believe that the time to overhaul the connection charge regulations is long overdue. The drafting of the current regulations is unclear and ambiguous, leading to differing interpretations.

Additionally the regulations lead to distortion of competition since a first comer receives no compensation when a second comer connects and where an ICP has undertaken the original connection works.

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

We believe a disputes resolution process is essential. This process should be operated by Ofgem. We are not aware of anyone else who could act as an independent arbiter.

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

No.