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13 July 2011

Dear Donald

### **Competition for part funded connections work**

Thank you for the opportunity to comment on the above consultation. This response should be regarded as a consolidated response on behalf of UK Power Networks' four distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, South Eastern Power Networks plc, and UK Power Networks (IDNO) Ltd.

We have carefully considered Ofgem's questions and have provided a detailed explanation of our position in the attachment to this letter. In summary, we share Ofgem's view that part funded work should not in itself disadvantage ICPs in competing to construct connection assets and that developing effective competition in this area will benefit customers. We look forward to working with Ofgem and the industry to agree a suitable way forward.

I hope that you will find our response helpful. Should you have any questions, please do not hesitate to contact me in the first instance on 01293 657853.

Yours sincerely

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## Appendix 1

### Detailed response

*Q1: 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?*

Ofgem estimates that some £820 million (26%) of connection work will be part funded over the period 1 April 2010 to 31 March 2015. While it is difficult to be precise, especially at this early stage of development of the proposals, we envisage that a significant proportion of this work would become contestable should these changes to the contestability rules be put into effect.

*Q2: 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?*

At this early stage we are not aware of any other fundamental changes that will need to be made in order to facilitate effective competition for dual funded works. However, as matters progress and the proposals are developed further it is possible that some refinements to the rules surrounding contestability will be required.

*Q3: 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.*

In our view, the calculation of the DNO's contribution to the part funded element of the connection should be based on the lower of either the DNO's or the ICP's costs and these costs must be readily comparable. Such a methodology will ensure that both the newly connected customer and the generality of all customers benefit from the introduction of competition in this area. Furthermore, we note that all three of the options proposed by Ofgem will require design effort on the part of DNOs. Regardless of the method of calculation used, the efficient costs of such work must be recoverable by DNOs through the price control.

*Q4: 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.*

A number of commercial issues will need to be addressed but none of those we have identified below are insurmountable. We look forward to working with Ofgem and the industry to agree a suitable way forward.

In particular, clarity is required as to which party will be responsible for the successful completion of the project. There will be circumstances where unexpected difficulties are encountered on site which will lead to additional costs being incurred. In such cases there is the potential for 'variation' charges to be passed on to both the customer and the DNO, but each party may have a different view on the proposed solution in respect of costs and timescales. There is also the potential for a misalignment of terms and conditions of contract between the ICP and the customer, and between the ICP and the DNO, associated with the way in which such variations are accommodated.

A possible solution may be for the DNO to make its payment to the customer instead of the ICP. The ICP would then be working for a single party (the customer) as is currently the case with contestable works. However, we recognise that this may introduce other complexities such as DNO intervention in the ICP/customer relationship or the need for a tripartite agreement or equivalent arrangements. Therefore this option needs to be considered in more detail.

With regard to the timing of DNO payments, we would not expect to make payment until after the works had been successfully completed. In the case of large projects, where the work is to be delivered in phases, it may be appropriate for the DNO to make staged payments dependent on the successful delivery of each phase of work.

*Q5: 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 our view, the percentage of costs borne by DNOs should not dictate whether part funded work is contestable. However, in some cases, due to the way the CAF calculation is structured, the customer may bear only a very small proportion of the reinforcement costs. Where this percentage is below a *de minimis* level (to be defined) we believe it may be prudent to remove this activity from the scope of contestability.

*Q6: Do respondents consider that DNOs should be allowed to earn a margin on contestable part funded connections?*

Yes, we consider that DNOs should be required to earn a regulated margin on contestable part funded connections work, as this will ensure a level playing field for all parties.

*Q7: 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 be applied to the customer funded element of the connection that is deemed contestable since it is a charge to the customer which attracts revenue i.e. in accordance with CRC12.

*Q8: We welcome respondents' views as to whether the introduction of competition would have any effect in respect of the RAV?*

At the moment we do not envisage any adverse impacts. However, we will need to develop a detailed mechanism which recognises the value of the part funded assets within the RAV.

*Q9: We welcome respondents' views on whether and, if so, under what circumstances, IDNOs should be able to adopt part funded network assets?*

From the information available to us in the consultation we are unclear of the rationale for what is being proposed. It would appear that the proposal is for assets funded partly by the DNO (via the RAV) and partly by the customer to be adopted by an IDNO. This would mean that the DNO would earn a rate of return on assets which do not form part of its distribution system and for which it has no ongoing liability. This would appear to be illogical and presumably the IDNO would be required to purchase the DNO funded asset

Furthermore, this would introduce the concept of IDNO assets being situated within the DNO's distribution system instead of at its extremity, as is currently the case. Over time it is likely that a number of IDNOs will have assets installed at different points within the DNO distribution systems and this will lead to a range of significant additional complexities on a variety of aspects, including capacity management, DUoS accounting, the new connection process and operational control. In addition, the physical network boundary arrangements that are provided within Engineering Recommendation G88 would need to be significantly enhanced.

Based on our interpretation of the high level proposals, it is not clear how customers' interests would be served by this structure which would significantly increase complexity and raises challenging practical issues. We would welcome an opportunity to understand more about how these arrangements would operate in practice.

*Q10: Do respondents consider there is any reason why such provisions cannot be included within the current regulatory arrangements?*

In principle, we see no reason why part funded connections work cannot be accommodated within the current arrangements as a contestable activity; however, Ofgem will need to be mindful of any potential interaction with the DPCR/RIIO process and the settlements DNOs have signed on to.

*Q11: We welcome respondents' views on the appropriate nature and location of such provisions?*

At this early stage it is hard to be precise as to detailed changes – these will need to be developed once the proposal is agreed. However, it would be sensible to try to avoid making changes to primary legislation (i.e. the Electricity Act) due to the complexities and timescales involved. Therefore we suggest that any changes are focused on the Distribution Licence, the Common Connection Charging Methodology (CCCM) and, possibly, the Regulatory Instructions and Guidance (RIGs). The Distribution Licence would be the vehicle for enabling/empowering changes, with the customer-facing requirements being set out in the CCCM and detailed instructions for DNOs in the RIGs, so that they are available for all parties to review.

*Q12: We welcome respondents' views on the need for and the appropriate nature of a dispute resolution process?*

Whatever arrangements are put in place for part funded connections work must be simple, pragmatic and workable in all cases in order to minimise the risk of disputes. From a practical perspective, we consider that disputes about part funded connections work are no different from any other connection related disputes dealt with by DNOs; therefore, ICPs, IDNOs and end customers should follow the DNO's established complaint resolution process initially, but have recourse to Ofgem (for determination) where the matter cannot be resolved to all parties' satisfaction.

*Q13: Do respondents have any views on any issues not covered above?*

We have identified potential issues with third party property rights and the landlord-tenant relationship where the work is carried out by an ICP. Reinforcement work may involve work in third party property: that is, property that is occupied or used by the DNO e.g. under a lease. If additional agreement or consent from the landlord needs to be obtained to carry out such work, it is unclear at the moment who will be responsible for obtaining this consent. On the basis that the reinforcement work is being carried out by the ICP for its customer, it is for the ICP or its customer to obtain that consent at its cost. Such consent would have to be granted by the landlord/third party property owner/occupier on terms that do not interfere with the rights of the DNO nor impose upon the DNO post-adoption, additional liabilities to the landlord/third party property owner/occupier.

We have also identified an issue with The Electricity (Connection Charges) Regulations 2002 (ECCR). It is generally acknowledged that the ECCR cannot be applied where assets are installed by an ICP because the regulations apply where an initial contributor has made a payment to the 'electricity distributor' and not where such payment has been made to an ICP. The effect will be that while an initial contributor will make a proportionate payment to the ICP for the reinforcement, following adoption of the assets the DNO will be unable to charge any 'second comer' a further proportion of the costs as it would do if it had installed the assets itself. A pragmatic solution would be for the ECCR to be reviewed as part of this work.

Additionally, we would like to seek clarity as to who would be the customer of the reinforcement works that are to be carried out. If they are carried out for the DNO, then to the extent that they fall within the Utilities Contract Regulations 2006 the DNO must not be compelled to award any contract/adopt assets/make payment in breach of those regulations. It would be asymmetric if the DNO is obliged to comply with those regulations but the customer/its ICP is not.

We believe that, once the proposals have been developed a stage further, it would be beneficial to seek customers' views on them to ensure that as an industry we are not developing a structure which becomes difficult to navigate and creates too much complexity.

Finally, in relation to the proposals put forward by the independent company, we would like to understand the background to these in more detail before we provide further comments. In particular, we are concerned by the proposal to require DNOs to publish information about connection requests received from other customers regarding the same or similar sites. Caution must be exercised here in order to ensure compliance with Section 105 of the Utilities Act and the Data Protection Act.

**UK Power Networks**  
**13 July 2011**