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Our ref

Your ref

Date

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Dear Rachel

Competition for part funded connections work: consultation document

I am writing on behalf of Western Power Distribution (South Wales) plc, Western Power Distribution (South West) plc, Western Power Distribution (East Midlands) plc and Western Power Distribution (West Midlands) plc, in response to Ofgem's Open Letter on part funded connections work.

I enclose a detailed response to the questions raised in the letter.

We are generally supportive of the proposal to extend contestability to allow competition for partly funded connections work. However, the options must be carefully thought through and the benefits weighed against the possible pitfalls. This should be considered not only against the immediate perceived benefit to the customer seeking the connection but also to the effect it may have on the on-going operation and maintenance of the distribution system. In view of this we do not support the proposal to allow the IDNO to adopt the assets.

Yours sincerely



ALISON SLEIGHTHOLM
Regulatory & Government Affairs Manager

Response to Ofgem's consultation document relating to Competition for part funded connections work

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?

It is difficult to determine what proportion of the reinforcement work would be eligible for consideration should part funded work become contestable but high level analysis suggests that costs would be split fairly evenly between cable overlay schemes which may largely be carried out separately from the distribution system and switchgear/transformer change schemes which largely may not. Therefore it may follow that the proportion of part funded work that would be deemed contestable in the case that the methodology is modified would be in the area of 40%.

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?

There would be a need to develop a suitable framework to administer any move to introduce competition for part funded connections. High level process could be outlined under the DNO's Statement of Methodology and Charges for Connection and any changes recommended following the consultation be referred to an industry stakeholder working group tasked with implementation.

Implementation plans should be mindful of developments in the area of Extension of Contestability. The design and specification of connection reinforcement works should remain under the remit of the DNO in order to allow them to look at the broader context and develop an economic and efficient distribution system.

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.

In order for competition to be extended in part funded connections work, it would be necessary to establish arrangements whereby DNOs would make price control money available to ICPs. On face value, option (iii) would be the most equitable option for all parties involved, i.e. customers, ICPs and DNOs. However, the calculation of the amount of price control money that should be made available is very complex and none of the options identified in Ofgem's letter dated 1st June 2011, consider the complexity. The issues that need to be considered in order to reveal the complexity of the calculation include:

- Treatment of the ICPs' closely associated indirect activity costs attributable to the DUOS funded element of the part funded connections work;
- Treatment of the ICPs' business support indirect activity costs attributable to the DUOS funded element of the part funded connections work; and
- RAV addition rules associated with direct costs.

For a part funded connections work project, a DNO's RAV additions can be vary significantly depending on the treatment of the ICP's indirect activity costs.

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.

DNO's should only be obligated to make a payment following successful connection and adoption of the assets to the distribution system. Obligations and rights may best be covered off under the Adoption Agreement.

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?

The DNO should be able to exercise some level of control on high value reinforcement schemes where the risk is inherently higher. What determines a high value scheme is debateable but as an example, the threshold may be set at £100k such that anything less than this value would automatically allow the part funded work to become contestable. Schemes equal to or greater than £100k could fall under a percentage rule whereby the part funded work would only become contestable if the DNO were contributing less than 75% of the costs.

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

It is not appropriate to allow a margin on contestable part funded connections work. It would not be appropriate to allow a margin on the proportion funded by DUOS as this would result in RAV reductions. By their nature, part funded connections works are funded from two sources, i.e. customers' connection charges and DUOS, with apportionment rules used to determine the proportion from each source. The customers' connection charges do not correspond to specific identifiable assets, but are hypothetical proportions of assets. Therefore it would be illogical to allow a margin on the proportion funded by customers' connection charges.

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?

As noted under Question 6, it is not appropriate to allow a margin on any aspect of contestable part funded connections work.

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

The extension of contestability to part funded connections work will have an impact on RAV. In our response to Question 3, we identified that net RAV additions can vary significantly depending on the treatment of the ICP's indirect activity costs. RAV addition is a complex issue that needs careful consideration in order to ensure that connecting customers, the wider customer base, ICPs and DNOs are treated equitably.

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

We do not believe that it is in the best interests of the end users or the network operators to allow IDNO's to adopt part funded network assets. Aside from the practicalities of introducing a mechanism that would ensure the end user was not paying any more via DUoS charges there are operational issues to consider relating to system management under fault or abnormal conditions. We would need to understand how the relationship between IDNO and DNO would work under IDNO fault conditions and how the IDNO would be incentivised to get DNO customers back on supply as quickly as possible in the event of a system outage. We would

also seek comfort relating to our reliance on IDNO intervention and how this might be treated under IIS reporting.

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

We agree the industry would need to formalise any mechanism requiring price control revenue to be made available to ICP constructed works that are adopted by the DNO. As we indicated in our response to Q9 we do not believe this should encompass IDNO adopted works.

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

Provision to allow price control revenue to be made available to the ICP should be captured under a change to electricity distribution licences and the connection charging methodologies. We would also need to consider the impact on customer reporting requirements and whether they should reflect such provisions.

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

If the calculation methodology and payment process is set out clearly under regulatory guidance there should be less scope for dispute. However, if agreement could not be reached we would anticipate using the existing disputes process with ultimate determination by Ofgem if required.

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

We are generally supportive of the proposal to extend contestability to allow competition for partly funded connections work. However, the options must be carefully thought through and the benefits weighed against the possible pitfalls especially with regard to allowing IDNO's to adopt part funded assts. This should be considered not only against the immediate perceived benefit to the customer seeking the connection but also to the effect it may have on other customers of the DNO and the on-going operation and maintenance of the distribution system. It remains a DNO obligation to develop an economic and efficient system. That is why we believe it is a step too far to allow the IDNO to adopt the assets.