

The reasons for the Authority's decision on Electricity North West Limited's 22 July 2011 application to charge an unregulated margin on certain contestable connections services

1 Summary

- 1.1 This document describes a decision made by the Gas and Electricity Markets Authority¹ on 21 November 2011. The decision regards whether Electricity North West Limited (ENWL), a distribution network operator (DNO), should be allowed to earn an unregulated margin on certain connections work.
- 1.2 The application by ENWL (in the form of a "Competition Notice") was made for nine different market segments. Having considered the ENWL Competition Notice and responses to our consultation we have not allowed an unregulated margin in six of those segments. We have made this decision on the basis that we have not seen sufficient evidence at this stage that customers' interests would be protected if we removed price regulation.
- 1.3 We have allowed an unregulated margin in three market segments where we consider there is evidence of competition and of buyer power. These are:
 - metered demand connections extra high voltage (EHV) work and above
 - metered distributed generation (DG) High Voltage (HV) and EHV work, and
 - unmetered connections private finance initiatives (PFI).
- 1.4 Our formal determination can be found on our website.² This document provides reasons for our decision. Annex 1 of this letter describes the responses received to our consultation.

2 Background

- 2.1 We have been working to facilitate competition in electricity connections since 2000. New entrants can compete with Distribution Network Operators (DNOs) to give customers a real choice over their connections provider and an opportunity to shop around to get good service and value for money. We consider that competition can deliver benefits for customers that are difficult to achieve through regulation, such as innovation in the type of services on offer and a focus from providers on meeting customer needs.
- 2.2 In general, we have been disappointed with the pace at which competition has developed in the electricity connections market. In 2009-10, 87 per cent of metered electricity connections across all DNO areas were completed by the incumbent DNO, compared to 41 per cent in the gas connections market.³
- 2.3 At Distribution Price Control Review 5 (DPCR5) we introduced an incentive on DNOs to do all that is within their control to facilitate competition in connection services.⁴ For the purpose of this incentive we defined nine Relevant Market Segments (RMSs) in which we considered competition to be viable.⁵ DNOs are able to apply

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² <http://www.ofgem.gov.uk/Networks/Connectns/CompinConn/Pages/CompinCnnctns.aspx>

³ For further information regarding competition in connections please refer to the Connections Industry Review - <http://www.ofgem.gov.uk/Networks/Connectns/ConnIndRev/Pages/ConnIndRev.aspx>

⁴ Details of this incentive can be found in DPCR5 Final Proposals Incentives and Obligations (<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=348&refer=Networks/ElecDist/PriceCntrls/DPCR5>) and in Charge Restriction Condition 12 of the Electricity Distribution Licence.

⁵ A policy decision was made at DPCR5 to establish the RMSs after consideration was given to the different types of connection (ie by size, type and customer base) for the purposes of this test. While we consider that they are

to have price regulation lifted in an RMS where they can demonstrate that competition is effective. We have made it clear to DNOs that where effective competition has not developed by 31 December 2013, we will review the position and consider taking action, including a referral to the Competition Commission.

2.4 In July 2011, ENWL was the first DNO to apply under this incentive mechanism.

3 Our assessment

3.1 Our decision on whether to lift price regulation is based on consideration of the extent to which ENWL has met two tests that were set out at DPCR5: a Legal Requirements Test and a Competition Test against the background of our statutory duties. This is a regulatory decision and does not amount to or imply any particular view as to the application or interpretation of the Competition Act 1998, and/or Articles 101 and 102 of the Treaty on the Functioning of the European Union, or any other law, either prior to this regulatory decision or once this regulatory decision is in place.

Legal Requirements Test

3.2 ENWL has satisfied the Legal Requirements Test in all of the RMSs as it currently has no enforced breaches of the Competition Act 1998 or of the relevant connections-related licence conditions in the 2011-12 regulatory year.

Competition Test

3.3 In considering whether the Competition Test had been satisfied, we considered a number of factors, including: actual and potential levels of competition; procedures and processes in place to facilitate competition; barriers to competition; customer awareness of competition; and ENWL's efforts to open up non-contestable activities to competition. In making our assessment we considered the nature of each market segment, the analysis provided by ENWL on the current level of competitive activity in its area, as well as information about the processes it has in place to support competition. We also considered responses to our consultation which provided us with further insight into the competitive environment in ENWL's area.⁶

Existing competitive activity

3.4 The market share analysis provided by ENWL in its Competition Notice only provided limited information on the level of competitive activity in each RMS. We recognise that the RMSs, defined for the purpose of the Competition Test, only came into force in April 2010 and historical analysis by RMS is not necessarily available. However, we consider that ENWL could have provided more detail on competitive activity in each RMS, including, the number of competitors, the respective market share held by each competitor, and the financial value of the RMSs. The absence of this type of information, in some instances, made assessing the level of competitive activity more challenging.

3.5 We do not consider that in each RMS the market share information provided by ENWL shows that competition is already at a level that in itself could protect consumer interests. In the absence of detailed analysis, we looked to responses to our consultation to gain further insight into levels of actual competition in ENWL's area. Although these responses gave an insight into the experiences of competitors and customers they did not provide the necessary additional reassurance, required

relevant in that context, any definition of the 'relevant market' for the purposes of competition law would not necessarily segment the market in the same way.

⁶ A summary of consultation responses can be found at annex 1.

in some RMSs, that competition is currently at a level that can protect consumers' interests.

- 3.6 Levels of competition in ENWL's area differ between market segments with their retained market share ranging from 100 per cent to 25 per cent. Information provided by ENWL to Ofgem shows that the majority of competitively won jobs in ENWL's area in 2010-11 were completed by six companies. However, at least 11 smaller players were also active. The market segments where competitors appeared to pick up the most significant proportion of the market were those typically made up of high value, large scale connections projects. These included the 'unmetered PFI' market segment where the market share of new entrants (in volumes) was 76 per cent, metered EHV market segment (75 per cent) and the distributed generation HV/EHV market segment (56 per cent). Market share is not a perfect indicator of competition in that small pockets of competition may act as a sufficient constraining influence to protect customers and that a relatively low retained market share does not automatically indicate that effective competition exists. However, for the purposes of applying the Competition Test, we consider that where ENWL has relinquished a significant proportion of the market to competition, we are more likely to be able to conclude that the tests for our decision in this case have been met.⁷
- 3.7 We note that consultation responses have indicated that some customers are already benefiting from innovation provided by alternative connection providers in ENWL's area, for example, through multi-utility offerings. We note concerns raised in response to our consultation that the benefits customers in ENWL's area are able to gain from using an alternative provider are constrained by the current extent of contestability. However, we are aware that ENWL is currently working to extend contestability in a number of areas including live jointing, point of connection self-determination and partially funded connections.

Customer awareness of and ability to choose competitive alternatives

- 3.8 We consider that for effective competition to exist customers must have a real choice of connection providers. For this, customers must be aware that alternative providers are available and be able to make informed decisions. We also consider that customers must have an effective choice, ie they must be able to choose a provider that can provide them with the service they expect to receive.
- 3.9 We note that the information provided by ENWL on its website and in its charging methodology appears to provide customers with information to allow them to explore competitive connection alternatives. We also recognise that while ENWL has a role to play in alerting customers to competitive alternatives, competitors must also take responsibility for promoting their services. However, we consider that there is still scope for ENWL to go further in educating customers on how to use competitive alternatives, in particular IDNOs.
- 3.10 Having considered the information provided by ENWL in its connection offers, we have not seen any clear evidence that the current breakdown of costs provided by ENWL prevents customers from choosing between ENWL and competitive alternatives. However, we note that further work is required across the industry to provide customers with the level of information they demand.

⁷ This is without prejudice to any other assessment of competition that Ofgem might separately undertake, including but not limited to any assessment under the Competition Act 1998 and/or Articles 101/102 of the Treaty on the Functioning of the European Union,.

- 3.11 Finally, we consider that where a significant proportion of connections in an RMS are undertaken by competitors, market share information can be a useful indicator of actual customer awareness of alternative providers.

The potential for further competition

- 3.12 This section considers the potential for competition, procedures and processes in place to facilitate competition, barriers to competition, and ENWL's efforts to open up non-contestable activities to competition.
- 3.13 We recognise that as there appears to be a significant level of competition in three of the RMSs discussed above, it has the potential to develop similarly across the remaining RMSs, where levels of competition are currently lower but processes and procedures are similar. We note the risk that continued regulation may have an adverse effect of stifling competition. However, we have also taken into account, the fact that the market segments where there are currently significant levels of competition typically consist of high value large scale connections projects. Projects of lower value in other market segments may be less commercially attractive to competitors. They may also find it more difficult to overcome any barriers to entry.
- 3.14 ENWL's Competition Notice included letters of endorsement from the House Builders Federation and four competitors (operating across a range of market segments) and responses to our consultation acknowledged ENWL as a leading DNO in facilitating competition. However, consultation responses also highlighted that some competitors have concerns that generic issues across the industry continue to prevent competitors from competing with ENWL on a level playing field. These include the limits DNOs place on the nature of activities independents can carry out, transparency of DNO pricing and the steps they take to ensure customers are aware of competitive alternatives. Although a number of respondents' concerns are currently being addressed through industry work streams, some responses to our consultation from both customers and competitors considered it premature to lift price regulation before these potential barriers to competition are addressed.
- 3.15 Responses to our consultation did not provide us with a sufficiently robust indication of competitors' ability or incentive to increase supplies or enter new RMSs. Furthermore, without the reassurance that may have been provided by a significant presence of competitors in a market segment, or clear indications of an intention to enter a market segment in the future, we have to be mindful that the generic issues raised by some respondents could be acting as barriers preventing competition from developing in these market segments.

Our conclusion

- 3.16 While mindful of the concerns raised in response to our consultation, regarding the continued existence of generic barriers to competition, we consider that in the unmetered PFI, metered EHV and DG HV/EHV RMSs, ENWL has relinquished a significant proportion of the market to competition. We therefore consider that it is difficult to justify continued price regulation in those RMSs. We have decided that the Competition Test has been satisfied in these segments for the reasons set out in this document. The analysis of market share provided by ENWL, and other relevant factors, shows that competition in these RMSs is already at a level that can protect customer interests, in the absence of price regulation. Furthermore, we note that these RMSs typically consist of high value, large scale connections projects where we consider that customers have significant buyer power.
- 3.17 In the remaining RMSs, we do not consider that the Competition Test has been satisfied. We have come to this conclusion as we have not seen sufficient evidence

in ENWL's Competition Notice or in responses to our consultation that suggests existing competition is at a level that is sufficient to protect consumer interests in the absence of price regulation. Furthermore, we do not consider that we have been given sufficient indication of competitors' ability or incentive to increase supplies or to enter these market segments. Without reassurance on these points, we have to be mindful that the generic issues raised in some consultation responses (regarding customer awareness, procedures and processes in place to facilitate competition and barriers to competition) could be preventing competition from developing in these RMSs.

4 Next Steps

For RMSs where the Competition Test has been satisfied

- 4.1 From the date of the Authority's determination (21 November 2011), we will no longer regulate the prices ENWL may charge in respect of any contestable connections services (fully funded by the customer⁸). In respect of those RMSs, ENWL will annually submit to us a report explaining any changes that have occurred in the RMSs since the date of the determination. In addition, ENWL will continue to be subject to competition law and licence enforcement. We will monitor and take seriously any breach of the Competition Act 1998 and/or of breach of licence obligations.

For RMSs where the Competition Test has not been satisfied

- 4.2 We will continue to regulate the prices ENWL may charge in respect of all of the connections services it provides. In respect of contestable connections services (fully funded by the customer) this means that ENWL will continue to charge the regulated four per cent margin allowed by CRC 12. If, at any time after four months from the date of the Authority's determination, ENWL comes to the view that the Competition Test has been satisfied in respect of these RMSs, it may reapply to have price regulation lifted by providing us with a second Competition Notice. We would encourage ENWL, and other DNOs considering making such an application, to consider carefully the reasons for our decisions which we provide in this document.

Future DNO applications

- 4.3 The process of assessing ENWL's Competition Notice has highlighted that a number of parties consider that competitors remain unable to compete with DNOs on a level playing field. We understand that DNOs are working both individually and collectively to remove barriers to competition, however, we note that in many cases this work is not yet complete. We expect future applicants to note, from our decision in relation to ENWL's Competition Notice, that they will not be deemed to have satisfied the Competition Test unless they can demonstrate clearly that either:
- a significant level of competition already exists in an RMS, or
 - that there is nothing to prevent competitors from entering new RMS.

⁸ Under the DNOs' connection charging methodologies, connections work that is defined as 'reinforcement' or is over and above the minimum scheme may be part funded by the customer and the company.

Annex 1 – Responses to Ofgem’s consultation on Electricity North West Limited's (ENWL) Competition Notice

- 1.1. On 12 August 2011, we issued a consultation seeking views from interested parties on ENWL’s Competition Notice. That consultation and responses received to it can be found on the Ofgem website.⁹
- 1.2. This annex discusses how we have considered ENWL’s Competition Notice and responses received to our consultation.

Assessment of existing competitive activity

- 1.3. In its Competition Notice, ENWL provided analysis of the level of existing competitive activity in its area. The historical analysis it provided (pre-April 2010) was based on data previously submitted to populate Ofgem’s annual Connections Industry Review (CIR).¹⁰ ENWL recognised the drawbacks associated with that data (for instance, that the CIR and RMS reporting categories did not necessarily match up¹¹ and that the CIR data only report completed jobs which may not show a meaningful view of market activity at the present time, due to the time lag between offer acceptance and project completion). To overcome these limitations, for the 2010-11 period it provided analysis based on accepted connection offers by RMS which it considered showed a more accurate picture of existing levels of competition. The headline figures based on volumes of accepted connection offers are summarised below. Please refer to ENWL’s Competition Notice¹² the full analysis:
 - In metered connections, ENWL asserted that it had lost 75 per cent of the EHV demand connections market and 34 per cent of the LV market to competitors. In the HV RMS, it asserted that it had lost 62 per cent of LV connections involving HV work and 41 per cent of HV only work.
 - In DG connections, ENWL asserted that it retained 100 per cent of the LV connections market and lost 56 per cent of the HV and EHV RMS.
 - In unmetered connections, ENWL asserted that overall it had lost 0.5 per cent of Local Authority (LA) connections, 76 per cent of Private Finance Initiative (PFI) connections and zero per cent of the ‘other work’ RMS to competitors. When considering only contestable unmetered connection activities, ENWL asserted that it had lost 0.7 per cent of LA connections and 94 per cent of PFI connections.
- 1.4. In addition, ENWL asserted that in 2010-11 there were 21 ICPs active in its area, six of which had been active since 2006-07. ENWL further asserted that in both 2008-09 and 2009-10 there were 17 ICPs operating in its area. ENWL asserted that the number of ICPs active in its area indicated that it did not impose conditions that restricted competitors from winning work and operating within its area.

⁹ Consultation on ENWL’s Competition Notice

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=319&refer=Networks/Connectns/CompinConn>

¹⁰ The CIR reviews competitive activity in the gas and electricity connection markets annually. It includes data on the number of connections, charges levied and performance against standards.

¹¹ CIR categories include connections that fall in the excluded market segments and jobs that are fully non-contestable (eg, service alterations).

¹² <http://www.ofgem.gov.uk/Networks/Connectns/CompinConn/Pages/CompinCnctns.aspx>

Consultation responses

- 1.5. In our August 2011 consultation we asked interested parties whether the market share data provided by ENWL in its Competition Notice gave a clear indication of the current level of competitive activity in each RMS. We also asked interested parties whether (in their view), considering the market share currently retained by ENWL and the number of ICPs currently active in each of the RMSs, competition in each of the RMSs is at a level that in itself indicates that effective competition exists.

ENWL's approach to analysing market share

- 1.6. Two DNO Respondents and an unmetered customer recognised the problems of relying on historical data gathered for the Connections Industry Review (CIR) to analyse market share. One DNO noted that they agreed with ENWL's use of accepted jobs (rather than completed ones) to consider 2010-11 market shares in the RMSs.
- 1.7. One DNO commented on ENWL's method of estimating the number of IDNO connections to their network, agreeing with ENWL's methodology. They added that the significance of the presence of IDNOs in a market should not be underestimated, as it brings a different form of competition. Another respondent considered that since ENWL stands to gain from ICP connections to its network (from asset ownership), numbers of IDNO connections can be considered a greater indication of effective competition (as the DNO stands to lose both the connections work and asset ownership).
- 1.8. An unmetered customer considered that, when analysing market share, we should consider the overall proportion of unmetered connections completed by ENWL (some of which remain wholly non-contestable) rather than limiting analysis to ENWL's share of the unmetered contestable activities only.

Levels of competition

- 1.9. Two DNO respondents considered that market share data taken on its own may not be a reliable indicator of competition. One highlighted that it is possible that a DNO may retain a high market share by providing a high quality of service at a competitive price. Furthermore it highlighted that we were right to be mindful of the distorting effect of continued regulation in contestable services. They considered that this could have the unintended consequence of stifling the scope for customers to benefit from competition. They also placed importance on considering whether there are any connections providers who do not currently operate within ENWL's area but could easily do so in the future. Some other respondents also supported taking a view of competition that was broader than market share. They considered that we should take into account barriers to competition and the ability of competitors to differentiate the service they provide.
- 1.10. Some respondents considered that they were not able to ratify or dispute the market share data provided by ENWL as there is not currently any market share information in the public domain for 2010-11. A customer group considered that while competitive businesses operate in ENWL's area, it is not clear how extensive this was. They considered the type of projects completed by ENWL's competitors important since they believed there may be an ongoing bias towards ICPs targeting large connections projects / frequent connectors. Another respondent stated that historically it had been difficult to get connections in ENWL's area and they thought the analysis completed by ENWL was too recent to determine any change in this

long term trend. They also thought that levels of competition, in absolute terms, were very small.

- 1.11. Three respondents considered that market share lost by ENWL to a former contractor (ie United Utilities Infrastructure Services) may mask actual levels of competition from new entrants to the market. A DNO highlighted that because of this former corporate relationship, the fact ENWL retains less market share than other DNOs does not necessarily mean that less barriers to competition exist in its area than in other DNO DSAs.
- 1.12. A metered customer group response highlighted concerns that ENWL has not provided evidence of the number of ICPs competing in each metered RMS, with data only provided for LV and HV connections. It considered that in the absence of that evidence it would be difficult for us to substantiate lifting price regulation. Further, they considered that the information set out in ENWL's Competition Notice regarding the number of ICPs active in providing LV and HV competitive connections, showed that the LV market is clearly still dominated by ENWL and that ENWL still has the largest share of the HV market. They considered that in a well established truly competitive market, the leading company's market share would be significantly below 70 per cent and that there would be more active competitors. An ICP active in ENWL's area agreed, stating that ENWL retained significant market share and are still the most dominant organisation in their region. They did not consider that there is enough competition in all market segments to allow competition alone to set prices.
- 1.13. An unmetered customer response considered the market share data made available by ENWL sparse. They noted that ENWL had not provided information on the number of ICPs active in the unmetered RMSs and they considered that the number was small. They considered it important, when analysing unmetered market share, to distinguish between the PFI RMS and other unmetered connections as the majority of market share lost by ENWL has been in that market segment. They stated that a stronger indication of lost market share was required in the 'LA' and 'other' unmetered RMS before they would consider effective competition existed.
- 1.14. One ICP respondent considered that ENWL had provided an accurate indication of the level of competitive activity in the unmetered connections RMSs. Further, an unmetered customer considered that levels of competition in the PFI RMS demonstrate that effective competition exists in that RMS. Another ICP respondent considered that, based on the data provided by ENWL and their own knowledge of the markets, there are clear levels of competition in all market segments in ENWL's area.

Our view

- 1.15. We recognise the limitations in the data provided by ENWL. We note that the RMSs, defined for the Competition Test, only came into force in April 2010 and that, because of this, historical analysis by RMS may not necessarily be available. We also recognise that ENWL did not provide detailed information of ICP activity by RMS in its Competition Notice (ie, the number of ICPs in each segment and the percentage of the market that they each hold) neither did it provide market share information for the metered demand HV/EHV market segment. Because of these limitations, we placed additional emphasis on competitors' and customers' views of levels of competition in each RMS. However, we do not consider that responses to our consultation on this point provided further insight than the analysis already available.

- 1.16. We note respondents' concerns that ENWL's lost market share could be attributed to its former contractor (United Utilities). We also agree that it would be difficult to consider levels of existing competition where limited data is available regarding the numbers of ICPs active in each RMS. Because of this, we sought further information from ENWL detailing the activity of competitors in 2010-11. Having considered this information, we are aware that the majority of competitively won jobs in ENWL's area in 2010-11 were completed by six companies. However, smaller players were also active with at least 11 competitors completing work. We note that no competitor operated across all of the RMSs in 2010-11, but this may be due to the limited amount of work available in some market segments.
- 1.17. We are aware of respondents' concerns that there may be an ongoing bias towards ICPs targeting large connections projects. Having reviewed the market share data available to it, we note that the RMSs where competitors appear to be picking up the most significant proportion of the market are those typically made up of high value, large scale connections projects.
- 1.18. We recognise that the 'actual competition' (ie, existing competitive activity) should not be considered in isolation of the other components of the Competition Test. Whilst we consider current market share an important factor to take into account in considering whether competition is effective in the RMSs, we also recognise that it can sometimes be an imperfect indicator. We note the risk that continued regulation in contestable services can have unintended consequences and stifle the scope for customers to benefit from the dynamic benefits, such as innovation, that competition can bring. For this reason, an approach that looks narrowly at market shares and retains price regulation until pre-defined thresholds have been met, may not necessarily be in customers' best interests.

Customer awareness of and ability to choose competitive alternatives

- 1.19. In our August 2011 consultation, we asked interested parties whether customers were aware that competitive alternatives were available and whether they considered they had an effective choice between competitive providers. We also asked whether customers considered that quotations provided by ENWL allowed them to make informed decisions between competitive providers and whether they considered they had benefitted from competition.

Consultation responses

Customer awareness of competitive alternatives

- 1.20. The majority of respondents considered that 'informed customers' were aware of competitive alternatives. One ICP considered that ENWL's customers were aware of competitive alternatives. A DNO respondent considered that customers, particularly repeat customers such as house builders, local authorities and developers, are now generally aware of competitive options open to them. An organisation representing house builders considered that awareness of competition in connections is extremely high amongst its members in ENWL's area. However, other respondents did not consider that all customers were fully aware of the extent of competition available in each RMS with one customer representative stating that only 40 per cent of its members knew they had a choice in connections provider.
- 1.21. An unmetered customer group stated that it had surveyed its members and that 60 per cent of them were either not aware of competitive alternatives or currently had no alternatives they whom they could place orders. An unmetered customer considered that large unmetered customers such as Local Authorities and Private

Finance Initiative providers were aware of competitive alternatives, but noted that there was little evidence that small unmetered customers are aware of competitive alternatives.

Measures taken by ENWL to ensure that customers are aware of and easily able to use the competitive alternatives available to them

- 1.22. An ICP considered that ENWL take all reasonable steps to communicate competitive alternatives. However, the majority of respondents considered that whilst ENWL did promote choice across the RMSs it was limited to the extent that they advise customers that an ICP can undertake contestable works. IDNO respondents highlighted that whilst ENWL's charging methodology and website reference competition in connections they do not give sufficient guidance of the process customers can follow to consider competitive alternatives. They also stated that ENWL are silent on customers' ability to use an IDNO. They considered that any customer awareness of competitive alternatives is down to the actions of competitors not ENWL. A customer representative accepted that ENWL's website promotes competition but considered that customers are equally likely to contact ENWL's call centre to discuss connection options. They stated that call centre staff have not shown a tendency towards promoting choice. Further they considered that ICPs needed to be more engaged in promoting competitive alternatives as they believe that with increased engagement/understanding customers may be more willing to try an alternative to the DNO.
- 1.23. An unmetered customer considered that ENWL takes a reasonable approach to making customers aware of competitive alternatives but felt that more could be done to inform unmetered customers of work currently underway to extend contestability (ie, live jointing trials).
- 1.24. When considering ENWL's quotations an ICP stated that, whilst more detail in quotes would always be welcomed, the level of detail provided by ENWL was acceptable and sufficient to allow customers to make informed decisions. However, IDNO respondents had concerns over the breakdown of charges provided by ENWL. One asked why ENWL's methodology stated it would only provide a breakdown of contestable works where the charge is over 20k. They did not consider that ENWL's current breakdown of charges enabled customers to understand the basis of charges to make informed decisions. They considered the same was true of non-contestable charges.
- 1.25. An unmetered customer stated that whilst schedule rate quoting (used for the majority of unmetered connections) was well established and understood, it did not provide a sufficient breakdown to enable customers to distinguish the contestable element. An unmetered customer group stated that 72 per cent of its members thought that quotations were not transparent.

Do customers have effective choice? Have they benefited from competition?

- 1.26. A house builders' representative considered that there is a wide spectrum of choice available to developers. They noted that ICPs offer single and multi-utility offerings and that recently IDNOs had begun operating in ENWL's area providing real innovation in the services they provide. An ICP operating in ENWL's area also considered that customers had benefited from their awareness of competition. However, the majority of other respondents considered that the current scope of contestability had limited customers' ability to benefit from competition as ICPs are currently not able to offer the full scope of services they are capable of delivering. Further, a customer representative considered that occasional connectors do not

always see the benefit of contracting an ICP if at various (non-contestable) stages the DNO will still have control or influence over the project. They compared the electricity connection market to the gas connection market where they considered a gas utility service provider will have total control of the service they provide from start to finish.

- 1.27. An unmetered customer considered that in unmetered connections only PFI customers with very large connection replacement programmes had benefited from competition. They stated that individual Local Authorities have generally low levels of connection activity and therefore do not have choice on a project by project basis. They considered that unmetered customers in ENWL's area had seen an increase in charges and little improvement in ENWL's service quality. However, they stated that they expected that in the future a new consortium of Local Authorities (the AGMA framework)¹³ would create a more competitive unmetered connections market.

Our view

- 1.28. We consider that the information provided by ENWL on its website and in its charging methodology appears to provide customers with information to allow them to explore competitive connection alternatives. We note some respondents' views that ENWL could go further to educate customers in how to use competitive alternatives. In particular, it notes concerns that ENWL's Connection Charging Methodology and website, whilst highlighting the existence of competitive alternatives, do not mention IDNOs. Our view is that ENWL's website should highlight the option of using any competitive alternative.
- 1.29. In considering whether customers are able to make an informed decision in choosing a connections provider we have considered the information provided by ENWL in its connection offers. We note concerns raised by an IDNO that ENWL's Connection Charging Methodology states that they will only provide a breakdown of charges in quotes for connections valued over £20K, however it is aware that ENWL actually provides a contestable and non-contestable split in all of its connection offers and a breakdown of contestable works in offers valued over £10k. Therefore, for metered connections, whilst we consider that further work is required across the industry to provide customers with the level of information they demand, we have not been provided with any evidence that the current breakdown of costs provided by ENWL prevents customers choosing between ENWL and competitive alternatives in the RMSs.
- 1.30. We recognise that whilst ENWL has a role to play in alerting customers to competitive alternatives, competitors must also take responsibility for promoting their services. Finally, we also consider that where ENWL has lost a significant proportion of connections in an RMS to competitors, market share information can be a useful indicator of actual customer awareness of alternative providers.
- 1.31. We note concerns raised in response to our consultation that the benefits customers in ENWL's area are able to gain from using an alternative provider are constrained by the current extent of contestability. However, we are aware that ENWL are currently working to extend contestability in a number of areas including, live jointing, self-determination of point of connection, and partially funded connections. Further, we note that some consultation responses have indicated

¹³ The Association of Greater Manchester Authorities (AGMA). A statutory combined authority made up of the ten authorities in Greater Manchester. It will co-ordinate key economic development, regeneration and transport functions, including street lighting replacement.

that customers are already benefiting from using provided by alternative connection providers in ENWL's area.

The potential for further competition

1.32. In our August 2011 consultation we asked existing and potential competitors for their views on the potential for further competition to develop in each of the RMSs and what influenced their decisions whether or not to work in a particular RMS. We asked them how ENWL's organisational structure and competition in connections procedures and policies compare to those they encountered elsewhere. In particular we asked, whether they considered any barriers exist that:

- prevent them from competing effectively with ENWL
- obstruct or delay connection providers entering ENWL's area
- obstruct or delay connection providers currently working in ENWL's area
- obstruct or delay connection providers currently working in ENWL's area in one or more RMSs, starting to compete in another RMS in ENWL's area.

We also asked whether, if barriers did exist, what their impact was and how they could be removed.

Consultation responses

1.33. A DNO respondent agreed that the ability of ICPs to enter into an RMS was an important factor to consider in assessing whether effective competition exists. A customer representative considered that the threat of competition had always been present and that it, in itself, should not be used as a lever to lift price regulation.

Attractiveness of the RMSs

1.34. Few existing or potential competitors' responses to our consultation provided details on what influenced their decisions on whether or not to work in a particular RMS. However, one ICP working the PFI and LA unmetered RMSs stated that there was potential for them to grow their market share and for new competitors to enter the market. They also considered that dependent on the economic climate and emerging opportunities, they would consider entering into additional RMSs. They did not consider that there were any undue restrictions to entering a new RMS or competing effectively in ENWL's area. An ICP working in the HV and unmetered PFI RMSs stated that as a competitor they considered it easy for new entrants to enter markets in ENWL's area. An ICP currently operating in the metered LV and HV RMSs in ENWL's area stated that whilst they did not consider there were any factors constraining them expanding in ENWL's area, they already see a high degree of competition there and so they see opportunities to expand elsewhere.

1.35. Two of the above ICPs stated that they did not consider that there were any RMSs, or geographic locations in ENWL's area, that by their nature, were unattractive to competition. However, an unmetered customer representative considered that low volume unmetered jobs did not attract ICP interest. They considered that in the current economic climate, where funding cuts constrain the size of LA street lighting replacement programmes, the AGMA framework appeared to be the only effective way for Local Authorities to attract ICPs.

Barriers to competition

1.36. Almost all consultation responses cited ENWL as a leading DNO in facilitating competition. Two ICPs operating in the demand HV and the unmetered RMSs considered ENWL easy to deal with and their processes and procedures appropriate.

They stated that they did not consider that barriers to competition existed and that they believed ENWL's approach to be best practice. An IDNO operating in the LV, HV and EHV demand RMSs and an ICP operating in the LV and HV demand RMSs, stated that where they encounter issues operating in ENWL's area ENWL will enter into dialogue and find pragmatic solutions. The IDNO added that where, in some instances, it has not possible for ENWL to change their procedures/processes they have provided an adequate explanation for their rationale.

1.37. Whilst they supported ENWL's application and did not consider that barriers to competition existed in any of the RMSs, one ICP considered that more could be done by ENWL to create a level playing field for competition. In particular they cited that until they are able to access network information (particularly load information) with the same ease as ENWL they will be at a disadvantage. A number of other competitors considered that barriers to competition (generic to the industry) existed that prevent them from competing effectively with ENWL. Other issues that were raised included:

- *The nature of agreements provided by ENWL* – Two respondents representing unmetered customers raised concerns regarding ENWL's requirement for ICP customers to be party to tripartite agreements in the unmetered RMSs. A respondent representing metered customers highlighted that whilst ENWL had recently introduced a bilateral agreement for metered connections their approach still did not give customers the flexibility they require. Another response stated that generally, across the industry, agreements are convoluted and one sided. They did not consider that ENWL had shown their agreements to be any different.
- *Price transparency* – An unmetered customer and an IDNO were amongst respondents that considered there was a lack of transparency in the allocation of costs that could be a barrier to effective competition. They raised concerns that indirect costs incurred in relation to contestable services could be unfairly apportioned to non-contestable only customers. They considered that this could lead to ENWL having unduly lower contestable charges and make it difficult for competitors to compete on an equitable basis.
- *Legal/commercial issues* – A respondent stated that land rights had historically caused delays to connections and that they would have welcomed some explicit proposals to address this from ENWL. It considered that competitors are effectively at the mercy of DNO lawyers with drawn out response times. It also questioned why ENWL insisted on certain land rights where it would not insist on the same land rights for itself in analogous circumstances.

Inspection and Monitoring processes – An IDNO highlighted onerous inspection and monitoring processes as a barrier to competition. Previously the Electricity Connections Steering Group has questioned whether the numbers of faults seen in adopted assets necessitated the level of inspection and monitoring DNOs require in some circumstances.

- *Design approval* – A respondent representing metered customers stated that each ICP, under the National Electricity Registration scheme (NERS), has a design procedure in place to ratify design assumptions and ensure there are no errors within designs. However, DNOs (including ENWL) require them to pay significant design approval fees thus causing them to incur additional costs to which the DNO is not subject. They considered that ENWL should allow ICPs with proven track records, to self-approve designs.

- *Final connections on existing mains* - Three respondents cited final connections on existing mains remaining non-contestable as a barrier to competition. A respondent representing unmetered customers stated that final connections to existing mains accounted for 42% of unmetered connection activity.¹⁴
- *Access to partially funded work* – Three respondents considered that competitors remain at a serious disadvantage whilst they were unable to compete with DNOs to complete work that is only partially funded by the customer.¹⁵
- Other issues raised by respondents to the consultation included boundary constraints and Use of System charging.

1.38. Two respondents stated that the competition in connections processes and procedures found in the gas connection market represented best practice. While they recognised ENWL as a leader amongst DNOs in facilitating competition, they considered that DNO practices (including ENWL’s) fell short of achieving the level of best practice they saw from Gas Distribution Network Operators (GDNs). They considered that whilst ENWL continues to control both the front and back end of the connections process, it will retain a competitive advantage. Further they considered competitors were prevented from being able to properly differentiate the service they offer to customers.

Efforts to open up non-contestable activities and to remove barriers to competition

1.39. A number of respondents to our consultation considered the extension of contestability key to stimulating further competition and praised ENWL’s approach. One ICP considered that the processes put in place by ENWL to trial live jointing on existing mains gave them a clear understanding of the steps required to gain entry to the market. Another ICP and a group representing metered connections customers considered ENWL’s approach to extending contestability sensible.

1.40. Whilst respondents noted that ENWL is taking steps to address a number of the barriers to competition they raised in response to our consultation, four considered that it would be premature to allow them pass the Competition Test before that work was complete. One respondent stated that, as a minimum, they would have expected ENWL to include a timetable in its Competition Notice which set out when the following would be in place:

- an arrangement to allow competitors to determine PoCs and allow them to self-validate designs
- procedures to allow competitors to complete final connections to existing mains, and
- connection offers that allow customers to accept both the contestable/non-contestable elements of a quote or to accept the non-contestable part only.

Our view

1.41. We recognise the general consensus among consultation responses that ENWL is a leading DNO in facilitating competition. However, we note that being a leader in the electricity connections market does not necessarily mean that barriers to competition do not exist in ENWL’s area. Further, we recognise that some competitors have highlighted concerns that barriers to competition exist that prevent them from competing effectively. We have not formed a view as to whether barriers to competition raised in response to Ofgem’s consultation are

¹⁴ Note work being undertaken to open this activity to competition discussed below.

preventing competition. We note that ENWL is working to address a number of the potential barriers to competition highlighted, however we understand that this work is not yet complete.

- 1.42. Whilst consultation responses included some positive feedback from competitors active across RMSs in ENWL's area, given the above, in the absence of conclusive evidence either way, we do not consider that we can be confident that potential competitors in each RMS always have the ability to compete with ENWL on a level playing field. Further, we have not seen sufficient evidence that existing or potential competitors have the ability or incentive to increase supplies or enter a new RMS.