



Making a positive difference
for energy consumers

To: All those with an interest in the market for new connections to electricity distribution networks.

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A chance to contribute to our review of the market for new connections to the electricity distribution system

Purpose

In the second half of 2014, we will review the market¹ for new connections to the electricity distribution system. This is in response to continued concerns about whether competition in this market is effective. The first step of our review is a call for information – which we are launching today.

This letter explains how you can submit evidence and engage with us during the review. We want you to tell us how well you think the market is working. The letter explains the background to this process, its scope and timing, and the possible outcomes.

Background

Competition in connections

The infrastructure which delivers electricity to customers' premises is the distribution network. New connections are made to the distribution network either when new customers want to take electricity off the network - for example a housing developer or supermarket - or put electricity onto the network, for instance a generator.

Not all new connections to the distribution network are made by electricity distribution network operators (DNOs). Competition exists for some work. A customer can choose to use an alternative provider for some connections work known as "contestable work". Contestable work can be carried out by:

- a DNO;
- an independent distribution network operator (IDNO); or
- an independent connection provider (ICP).

Effective competition in these markets will help improve the quality of service that customers receive and reduce the cost of connection. Competition can also encourage innovation in the type of services on offer. A well-functioning market for connections to the distribution network should benefit us all – connections that are timely and cost-effective help the economy to grow and help to decarbonise the energy we use.

¹ In this letter we use the terms 'market' and 'markets' to refer to different segments of the energy sector. For the avoidance of doubt, these terms are not intended to describe or otherwise suggest the approach that may be taken by us for the purposes of market definition, for example in competition law investigations.

But when we developed proposals for the current price control (Distribution Price Control Review 5 (DPCR5)), we were concerned about how effective competition was for new connections. So we brought in measures to improve the conditions for competition. Collectively these measures are referred to as the 'competition test process'. They are described in appendix 1. Our final competition test decisions were made in April 2014.²

Outcome of the competition test process

In total, through the four-year competition test process, we received applications for price regulation to be lifted in 113 of the 126 Relevant Market Segments (RMSs) (14 licensees x 9 RMSs). In 42 RMSs, we were satisfied that there was evidence of sufficient competition to protect the interests of customers in the absence of price regulation. There is a breakdown of the applications received and our decisions on them in appendix 2.

We consider that the process has, to some extent, improved the state of competition in the market. DNOs have addressed some of the barriers to competition and stakeholders report improvement in certain areas. It has also successfully highlighted differences in the state of competition and, potentially, the effectiveness of DNOs in encouraging competition across different parts of the market.

While competition has developed in some sections of the market, the results of the test show that it has not taken hold in all areas. As well as this evidence, stakeholders have raised concerns with us about the nature of competition. Our key observations of the competition test results are that -

- Competition has become more prevalent in some DNO areas than in others. This could be due to differences in economic factors, geography, the appetite of competitors, DNOs' behaviour, or DNOs' efforts to improve the environment for competition.
- It appears that some RMSs may have better conditions for competition than others. A hypothesis is that competitors may be more active, or successful, where larger-value works are at stake. If there are areas where market features prevent competition from developing, we are conscious that pursuing our regulated margin policy would not be appropriate.

Given these issues we are now reviewing the market to identify why competition has not developed as effectively in certain RMSs or DNO areas.

Our review of the market

Our review of the connections market will build on the information we have gathered through the competition test process and seek to establish why there are differences in the effectiveness of competition across the market. If it demonstrates that problems in the market are persisting, we will take steps to address these issues.

Scope

We are considering the entirety of the market for new connections to the electricity distribution system. For the avoidance of doubt, this includes both where the competition test has and has not been passed by DNOs.

² All of our decisions on the competition tests can be seen here - <https://www.ofgem.gov.uk/electricity/distribution-networks/connections-and-competition/competition-connections>

Timing

The first stage of our process is a call for information.³ **Please send us any information about the market by 31 July 2014.** We will publish an update in the autumn explaining what we think the information shows about how competition is working. We will then invite views on this assessment.

After we've considered these, we intend to make a decision on whether any further action is necessary by the end of 2014. Any further measures will depend on our conclusions as well as any new developments in the market.

The table below summarises the activities we will undertake on this project and our indicative timetable.

Step	Activities	Timing
Information collection	<ul style="list-style-type: none">This call for information	June and July
	<ul style="list-style-type: none">We will host a briefing on how to respond to the call for information	8 July
Considering information	<ul style="list-style-type: none">We will run bi-lateral meetings with customers and competitors to discuss the information provided.	August and September
	<ul style="list-style-type: none">We will review information provided to us to explore the factors that impact upon the effectiveness of competition.	
	<ul style="list-style-type: none">We will publish all non-confidential evidence.	
Update on assessment of competition	<ul style="list-style-type: none">We will aim to give an update on our assessment based on the information received. The timing of this update will depend on the nature of the information received and further analysis we need to undertake.	Around October
	<ul style="list-style-type: none">We will invite views on our assessment.	
	<ul style="list-style-type: none">We will invite views on what further steps should be taken, if any, based on the evidence that has been collected.	
Decision on further action	<ul style="list-style-type: none">We will decide whether any further action is required by the end of 2014.	By end of 2014
	<ul style="list-style-type: none">Our decision will be informed by our assessment of the state of competition, stakeholders' views and further developments in the market.	

³ We are issuing this call for information on the basis of our general market monitoring function as set out in s.47 of the Electricity Act 1989.

Potential Outcomes

Any future intervention in the connections market will depend on our assessment of the evidence provided through this process. But it is useful to explain the main options that are open to us -

- *Enforcement Action* – we could open an investigation using our powers under the Competition Act or sectoral legislation in the event that evidence emerges through our review that companies have failed to comply with the relevant legal obligations. In considering whether to take enforcement action, we would take account of our published prioritisation criteria.⁴ Enforcement action could be taken in parallel with one of the other outcomes.
- *Regulatory remedies through licence conditions* – we may decide that the evidence demonstrates that there are failures in the market which could be addressed using regulatory powers.
- *Market Investigation Reference* – we could refer the market - or sections of the market - to the Competition and Markets Authority to undertake a market investigation, if we consider that there are reasonable grounds for suspecting that any feature, or combination of features, of the market prevents, restricts or distorts competition.
- *Do nothing* – we may conclude from the information provided, and based on other developments in the market, that no further steps are needed to improve the effectiveness of competition in the market.

Adoption of best practice during the review

Calling for information will help to identify and prioritise issues which are holding back the development of competition in the connections market. There are many reasons that could explain why competition has been slow to develop in certain parts of the market. It could be due to differences in economic factors, geography or the appetite of competitors.

However, where DNOs can identify good practice adopted by others, or where they get specific customer feedback - either through this review process or directly - we encourage them to take action to improve their processes, procedures and behaviour. We think it would be better for individual DNOs (or the DNOs collectively) to deal with such issues themselves during the course of 2014, rather than waiting for Ofgem action.

With this in mind we urge DNOs – as a first step - to think about the problems identified in appendix 3 and consider the changes they can make. We would welcome discussions with the DNOs on any areas of improvement that they are considering.

The call for information

We are calling for information to help us understand the full range of issues and concerns that you have about how the market is working. Our understanding of the type of problems that alternative connection providers or customers face has been greatly enhanced by the responses we have received through the competition test process. But we need more information. We want to understand the extent to which these issues impact upon competition in different parts of the market and in different DNO regions. This information will also inform our understanding of what steps we need to take to address these issues.

⁴ Our latest enforcement guidelines can be seen on our website - <https://www.ofgem.gov.uk/publications-and-updates/enforcement-guidelines-complaints-and-investigations>

There are two questionnaires that will help us collect this information. One is for customers, the other for independent providers (ie IDNOs, ICPs and DNOs when acting outside of their licence area). We have designed these questionnaires specifically to seek the views of these stakeholders. However, should DNOs or others feel that they can offer insight into the issues that the questions explore we would encourage them to also complete the questionnaires or provide separate responses. DNOs have provided significant information about these issues through their competition test notices, which will be considered as part of the review.

The customer's questionnaire

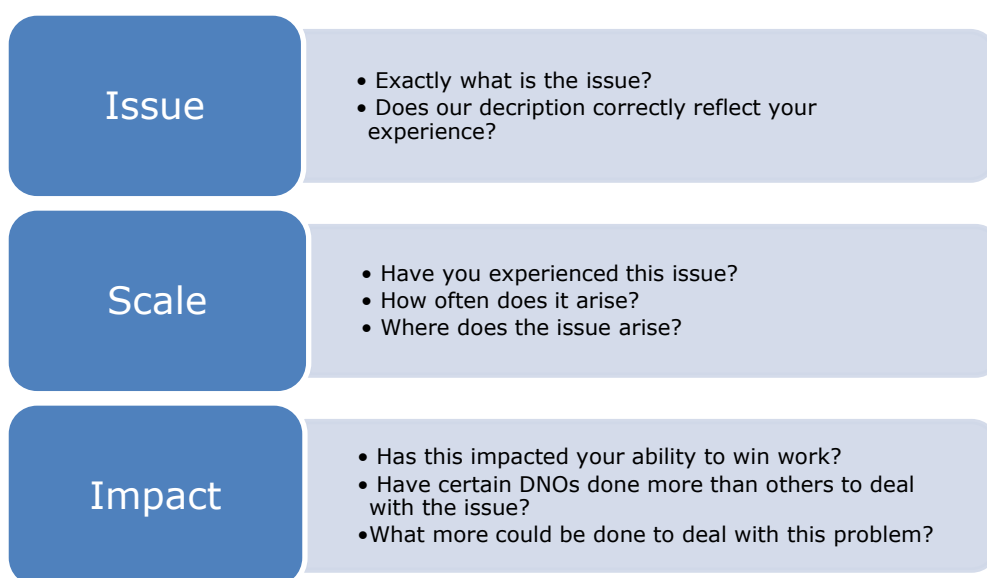
We want to understand what you think about this market and what you think about when you are looking for a connection. To help capture your views, we have designed a questionnaire for you to complete. Please complete the Word version of the questionnaire [here](#).

Please submit your completed questionnaire to Connections@ofgem.gov.uk by 31 July 2014.

The independent provider's questionnaire and issue templates

We have identified concerns that have been raised through the competition test process. These are explained in appendix 3.

Now we want you to tell us whether these are a concern for you, and tell us a bit more about them. To help capture your views, we have designed a questionnaire for you to complete. It includes [issue templates](#) to capture your thoughts about specific issues. Each template describes an issue and includes several questions to help prompt your response. These are illustrated below.



A full list of the issues we have identified is provided in appendix 3. We anticipate there will be some problems we haven't identified yet. There is a blank template for you to complete for any additional issues that you think impede competition in the market.

Please complete the Word version of the questionnaire and issue templates [here](#).

Please submit your completed questionnaire to Connections@ofgem.gov.uk by 31 July 2014.

Other information

In addition to the questionnaire described above, we will accept other information provided by customers, competitors or other stakeholders by the response deadline.

Confidentiality

We recognise that some of the questions that we are asking may require you to provide responses which reflect your future business plans or strategy. We will accept confidential responses to the call for information.

Any information provided to us which relates to the affairs of an individual or a particular business will be subject to statutory restrictions on disclosure under section 105 of the Utilities Act 2000. However, you should note that there are exceptions to the statutory restrictions, including where the disclosure is necessary to facilitate the statutory functions of Ofgem (for example, publishing information to promote the interests of consumers) or other public bodies.

You should note that we also cannot provide any assurances in relation to the treatment of information which may be the subject of a request made under the Freedom of Information Act 2000 ('FOIA'). However, we will always consider whether the statutory restrictions on disclosure apply to the requested information and therefore whether one or more of the FOIA exemptions apply.

Before deciding whether to publish any information relating to the affairs of a particular licence holder or business, Ofgem is required to consider whether it is appropriate to redact any information on the basis that the information would or might, in our opinion, seriously and prejudicially harm the interests of that person ('confidential information'). In order to enable us to conduct this assessment (in the event that the possibility of publishing information is considered), we would ask that you indicate in your response whether you consider any information to be confidential information and provide brief reasoning in support of your views. Where appropriate, we may seek further representations from licence holders at a later stage in respect of any specific information we are proposing to publish for any other purposes.

Meeting with you and other stakeholders

We are holding a meeting for stakeholders to discuss the issues raised in this letter in London on 8 July 2014.

If you would like to attend this event, please email Connections@ofgem.gov.uk by 27 June 2014.

Contacting us

If you would like to discuss the contents of this letter please email us at the connections email address, or call James Veaney on 020 7901 1861.



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Smarter Grids and Governance

Appendix 1 – Background to the Competition Test

In 2010, we introduced measures to remove regulatory barriers to competition and to provide strong incentives for DNOs to support competition. These were -

- Introducing a regulated margin, of four per cent above cost, which DNOs have been required to charge customers when they provide competitive connection services. This is to encourage independent connections providers to enter the market and compete for work with DNOs.
- Creating the 'competition test' assessment process, whereby DNOs could apply to us to have price regulation lifted, if they could demonstrate that competition had developed sufficiently to constrain prices. DNOs had until the end of 2013 to apply to pass the competition test. This encouraged DNOs to change their procedures and policies to let competition develop.
- Defining the contestable connections market into nine 'relevant market segments' (RMSs) for making the competition test assessment. Separate competition test applications were required for each segment.
- Committing to review the connections market if effective competition had not developed by the end of the competition test process. We have consistently said that further action could then be taken which could include an Enterprise Act 2002 Market Investigation Reference to the Competition Commission (now the Competition and Markets Authority (CMA)).

We made our final decisions on the last competition test assessments in April 2014.

Appendix 2 – Representation of outcome of competition test process

RMS	Electricity North West	Northern Powergrid		UK Power Networks			Western Power Distribution				SSE		SP	
		Yorkshire	North East	EPN	SPN	LPN	East Mids	West Mids	South West	South Wales	SHEPD	SEPD	SPD	SPM
Metered demand LV	Pass	Did not apply	Did not apply	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not apply	Did not apply	Pass	Did not pass
Metered demand HV	Pass	Pass	Pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Pass	Did not pass
Metered demand HV & EV	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Pass	Pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass
Metered demand EV & Above	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Pass	Pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass
Distributed generation LV	Did not pass	Did not apply	Did not apply	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass
Distributed generation HV & EV	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Did not pass	Did not pass	Pass	Did not pass	Did not pass	Pass	Did not pass	Did not pass
Unmetered Local Authority	Pass	Did not pass	Did not pass	Pass	Pass	Did not pass	Pass	Pass	Pass	Pass	Did not apply	Did not pass	Did not pass	Pass
Unmetered PFI	Pass	Did not pass	Did not pass	Pass	Pass	Pass	Pass	Pass	Pass	Pass	Did not apply	Pass	Did not pass	Pass
Unmetered other	Did not pass	Did not apply	Did not apply	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass	Did not pass

Key	
Pass	Pass
Did not pass	Did not pass
Did not apply	Did not apply

Appendix 3 – Issues we have identified through the competition test process

We have identified a number of issues associated with competing for work in the market. These relate to concerns that have been raised through the competition test process. These are listed in this appendix. We are asking for your comments on these issues through this call for information.

Issue A - The DNO's level of control over the connection process

To safeguard network integrity, DNOs insist on controlling some of the activities associated with network connections. So competitors have to interact with DNOs at certain points of the process. This can cause tension and may make it more difficult for a competitor to win work. Some examples are given below.

Competitors need to provide quotes to customers in order to win work. This involves designing and costing a connection. Their ability to do this independently is currently limited because:

- To quote for a job a competitor will need to know where they can connect to a network. For the competitor to establish their own point of connection they will need to apply to the DNO to get access to network diagrams and information.
- The DNO must then approve the design of the competitor's connection.
- Alternatively a competitor can ask the DNO to offer them a point of connection (POC) to the existing network.

This dependency on the DNO may make it difficult for competitors to issue quotes in the same amount of time as (or faster than) a DNO. Competitors are less able to control timescales involved than the DNO and are reliant on DNOs meeting agreed timescales. We can also see that this process could lead to tension (or at worst discriminatory, anti-competitive behaviour). For instance, ICP designs may be rejected unnecessarily by DNOs. There is a risk that less favourable connection points could be issued to competitors than are issued by the DNO to its own customers.

In addition DNOs may place requirements on competitors to protect the wider network that can add to the cost associated with using a competitor. For instance -

- DNOs can ask for link boxes to be installed at the network boundary with an IDNO.
- DNOs can insist upon ICPs being subject to their own accreditation regime before they are permitted to make a 'live' connection to a DNO's network.
- DNOs can insist on their own inspection and monitoring regime to audit the work of a competitor before a connection can be made.

The above issues, either in isolation or combined, could result in difficulty for competitors to provide quotes and ultimately win work. There is also a risk that the complexity of interaction between the competitors and DNO deters customers from seeking quotes from a range of providers.

Issue B - Complexity for customers

We have been told that some aspects of some connection process can cause confusion for customers:

- Transparency in quotes - Competition should be most effective where customers are able to compare the costs that will be charged by the DNO against those of an independent. Stakeholders have raised concerns that quotes are difficult to

understand because the content of work is not always clear. This could disadvantage customers as they might not be able to easily compare costs between the DNO and an independent.

DNOs have improved transparency but recent responses to some competition tests suggest that there is still more to do, such as removing miscellaneous charges in quotes.

- Difficulty in accepting just the non-contestable part of a DNO's quote - In some DNO areas, problems can arise when customers accept a non-contestable quote from a DNO, but decline the contestable element and choose to use an independent. If this happens, some DNOs may reissue the costs of the non-contestable works. This can discourage customers from using independents, as doing so will increase the time taken to receive a quote and add uncertainty to the cost of any non-contestable works. We are aware that some DNOs have introduced fully transferable quotes to address this issue. But this is not yet standard practice across the industry.

Issue C - Customer appetite for competition

We have been told that some customers may not be convinced of the benefits of using alternative providers:

- Customers don't know they can use alternatives - Some customers are still unaware that they can choose an alternative provider. This is a long-standing problem. We think awareness has improved with DNOs now providing information on alternative providers, but a lack of awareness remains for some types of customers (eg smaller customers) and is still impeding competition.
- Customers' willingness to use independents - In response to the competition tests, some stakeholders have noted that some customers are reluctant to use competitors. Stakeholders have suggested this is because of a perception of increased risk of higher costs, extended timescales or greater 'effort' when using independents compared to the DNO. Some stakeholders have said that the cost savings of using a competitor aren't sufficiently significant. This may particularly be the case for lower value work.

Issue D - The impact of regulatory regimes and requirements

- Statutory powers - Through their licence DNOs have statutory powers that make conducting street works easier than if a non-licensee (ICP) carried out the work. This can make it more difficult for some independents and may make smaller jobs unattractive.
- Requirement for emergency response service - In the event of a fault on the network, DNOs and IDNOs are required by their licence to provide certain services to customers on their network. This includes information and fault restoration. Some stakeholders argue that the requirements to provide this service imposes costs that could stop new IDNO entrants entering the market or existing participants expanding. They also note that DNOs are more easily able to cover such costs through their regulatory revenues.
- Part funded connections - When conducting a connection project, a DNO may decide to carry out additional wider work on its network. If it does, the cost of reinforcement will be shared between the connecting customer and the wider customer base. If a customer contracts with a competitor for all of the work there will be no cost sharing. This may restrict the independent's ability to compete with the DNO on price for certain work.

- Pricing - we want to understand the extent to which independents can compete on price in various sections of the market.

Issue E - Little evidence of competition for certain types of connection

We have seen little evidence of competition in certain types of connection during the competition test process. No DNO passed the test in the 'distributed generation low voltage' or 'unmetered other' RMSs. There may be specific issues affecting competition for these types of connection. This could be because of:

- the total value of the work (and high proportion of non-contestable costs);
- the value of the work versus the costs or effort required to win it (for instance the processes complexity);
- the sporadic nature of the work; and/or
- high entry costs (accreditation etc).