

The Company Secretary
Southern Electricity Power Distribution Plc
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Date: 10 April 2017

Dear Company Secretary,

Decision in relation to Southern Electric Power Distribution Plc's ("SEPD") proposed changes to its Connection Charging Methodology

On 14 March 2017, SEPD submitted a proposal to us¹ to modify its Connection Charging Methodology. Having considered the proposal, we have decided **not to veto** the proposed modifications.

This letter sets out the background to the modification proposal, summarises the proposed changes and explains our decision.

Background

In accordance with Standard Licence Condition ("SLC") 13 of the Licence, SEPD is required to have in force at all times a Connection Charging Methodology which we have approved on the basis that it achieves the Relevant Objectives.² The Connection Charging Methodology outlines the method by which connection charges are determined.

SEPD has proposed to modify its Connection Charging Methodology to help improve clarity and facilitate changes being implemented by SEPD (i) following implementation of the Competition in Connections Code of Practice (CiCCoP)³ and (ii) to address competition concerns identified by us during an investigation about an alleged abuse of a dominant position.⁴

¹ Ofgem is the office supporting the Authority. The terms 'us', 'we', 'Ofgem' and 'the Authority' are interchangeable for the purposes of this letter.

² The 'Relevant Objectives' for the Connection Charging Methodology are:

- (a) that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by this licence;
- (b) that compliance with the methodology facilitates competition in generation and supply of electricity, and does not restrict, distort or prevent competition in the transmission or distribution of electricity;
- (c) that compliance with the methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee and its Distribution Business;
- (d) that, so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's Distribution Business; and,
- (e) compliance with the Regulation and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators.

³ The Competition in Connections Code of Practice (CiCCoP) can be found here; http://www.connectionscode.org.uk/assets/files/CiCCoP_final_January2017.pdf

⁴ Specifically, we were concerned that, for transactions which appeared to be equivalent, SEPD was providing different quotes for Non-contestable activities to IDNO's/ICPs, than to its own connections business. More information on our investigation and our decision to formally accept legally binding Commitments can be found [here](#).

SEPD's proposed changes

In SEPD's methodology, connection activities that are open to competition are identified as "Contestable" and activities that are not open to competition as "Non-Contestable".

SEPD state that the changes provide additional clarity on which activities are now open to competition. SEPD confirm that the proposed amendments do not change any task from Contestable to Non-Contestable (or vice versa).

SEPD's proposals to modify its Connection Charging Methodology Statement are summarised below. Specifically, SEPD propose to:

1. Amend paragraph 6.3 and 6.4 to highlight where stakeholders can find additional information on which activities are Contestable.
2. Amend paragraph 6.10 and 6.14 to align how inspection and monitoring (I&M) costs for the minimum level of inspections ('Level 3')⁵ are recovered for Point of Connection (PoC)⁶ and All Works quotations customers.⁷

Unlike All Work quotations, PoC quotations historically did not include upfront I&M charges, instead expenses were recovered retrospectively from an Independent Connection Provider (ICP) once a specific inspection was carried out. SEPD propose to partially amend this so that the costs associated with I&M for the minimum level of inspections ('Level 3') are spread across all customers and recovered upfront, regardless of the type of connection quotation requested. This change is driven by the changes being introduced by SEPD to ensure that all quotations are dealt with on a broadly equivalent basis. SEPD are not proposing to amend how I&M costs are recovered for ICPs that require a higher level of inspection (eg for an ICP in the 'Level 1' or 'Level 2' category of I&M). The 'Level 1' and 'Level 2' I&M costs will continue to be recovered retrospectively from the specific ICP.

3. Modify paragraphs 6.10-13 to clarify that SEPD will be subject to the same inspection standards as ICPs.
4. Modify the table in section 6.19 to:
 - i. Separate 'Unmetered Connections' activities into a discrete category, to provide additional clarity on which tasks are Contestable. Previously unmetered tasks were incorporated into the wider list of activities.
 - ii. Amend the 'Determine PoC to Distribution System' and 'Design Approval' categories to make it clearer that these tasks are contestable for certain projects.
 - iii. Amend the description of the "Plant and materials specifications" category to make it clearer that this is only relevant when the assets are adopted by SEPD.
 - iv. Amend the description of the 'Land Rights negotiations with third party landowners' category', to make it clearer that this category includes negotiating planning and consents.

⁵ SEPD inspects and monitors the work completed by ICPs to ensure that it is of an appropriate quality. The percentage of an ICP's work that is inspected by SEPD is dependent on the level of inspection that the ICP is subject to. There are three levels of inspection ('Level 1', 'Level 2' and 'Level 3'). ICPs are subject to more scrutiny under 'Level 1' (where 40 per cent of Low Voltage work is inspected) than 'Level 3' (where 2 per cent of Low Voltage work is inspected). If an ICP is able demonstrate that it can successful complete work to an appropriate quality, then an ICP is able to progress to the next level of inspection and reduce the amount of scrutiny from SEPD.

⁶ "Point of Connection quotations" or PoC quotations are connection quotations to only complete the Non-Contestable connections activities.

⁷ "All works quotations" are connection quotations to complete the Non-Contestable and Contestable connection activities.

- v. Split "Prepare wayleave/easement/planning consents documentation and enter into agreements with third party landowners" into two categories. This is to add clarity that although entering into the agreements is Non-Contestable, preparing the documentation is open to competition.
- vi. Simplify the table to remove the distinction between excavation "on site" and "in the public highway", because both are open to competition.
- vii. Combine all jointing to connect Contestable works into one category. This new category is identified as being both Contestable and Non-Contestable. This is to provide clarity that although the task is Contestable, if an ICP chose not to complete the task, then SEPD would complete the task as a Non-Contestable activity.
- viii. Change the 'Commissioning and connection of Extension Assets to the Distribution System' from Non-Contestable to Contestable to reflect changes already implemented as part of the CiCCoP.
- ix. Add "Disconnections" as a new category of works to provide clarity that these activities are Non-Contestable.

Ofgem's decision

We have analysed this proposal by taking into account both the relevant objectives and our wider statutory duties. We consider that the proposed modifications better achieve relevant objectives (b) (c) and (d). We explain the reasons why below:

(b) that compliance with the methodology facilitates competition in generation and supply of electricity, and does not restrict, distort or prevent competition in the transmission or distribution of electricity;

We consider that the proposed changes make it clearer to stakeholders, including prospective ICPs, which connection activities are open to competition. We believe that this will help facilitate competition in the distribution of electricity.

The proposed changes mean that all PoC quotations will include 'Level 3' I&M charges upfront. As a result, ICPs in the 'Level 3' I&M category will not incur additional I&M charges at a later date. We consider that having certainty upfront on 'Level 3' I&M costs will provide customers with additional certainty on an ICP's connection charge, thus making the ICP a more attractive option. We consider that the proposed changes also make ICP charges more cost reflective (see relevant objective (c) below), we believe that this will also make ICPs more attractive for prospective customers. We therefore consider that the proposed change better achieves relevant objective (b).

We note that SEPD has not proposed to change these arrangements for 'Level 1' and 'Level 2' I&M costs. This means that the costs for 'Level 1' and 'Level 2' I&M are still recovered retrospectively from the jobs that are randomly chosen for inspection. This may be an aspect of the methodology where further changes could be justified to align with the approach used for 'Level 3' I&M costs.

(c) that compliance with the methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee and its Distribution Business;

All ICP are subject to at least 'Level 3' of SEPD's I&M regime. SEPD incurs costs administering this regime. SEPD's currently only recovers these costs from those jobs where an inspection is randomly chosen to be carried out. We consider that the proposed change to spread 'Level 3' I&M costs across all jobs results in charges for each customer which better reflect, as far as is reasonably practicable, the costs incurred by the licensee administering the I&M regime. We therefore consider that the proposed change better facilitates relevant objective (c).

To ensure that the charges incurred by the ICPs remain cost reflective, we consider it important that the additional charges associated with 'Level 1' and 'Level 2' inspections continue to be paid for by ICPs in those categories. This ensure that those ICPs requiring greater oversight face higher I&M charges.

(d) that, so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's Distribution Business;

We consider that the proposed changes will better facilitate relevant objective (d) by properly taking into account recent changes that SEPD has made to its business to implement the CiCCoP and their legally binding Commitments. For example, the proposed changes to I&M charges will allow SEPD to implement their Commitment to ensure that they charge themselves and ICPs on a broadly equivalent basis.

Overall, we consider that the proposed changes will better facilitate relevant objectives (b), (c) and (d). Consequently, we have decided **not to veto** SEPD's proposed modifications to its Connection Charging Methodology.

Nothing in this decision should be interpreted as releasing SEPD from its obligations under standard licence condition 52 of the electricity distribution licence⁸ to continue to facilitate competition in the Local Connections Market by (i) minimising, to the fullest extent reasonably practicable, the number and scope of Input Services which are only available from the licensee (ii) providing Input Services on an equivalent basis to all Connection Parties that operate in the Local Connections Market and (iii) removing, to the extent that it is within its power to do so, any barrier associated with managing and operating its Distribution Business, which would prevent entry to, or continued participation in, the Local Connections Market.

Please contact Stephen Perry at stephen.perry@ofgem.gov.uk or on 020 7901 1806 if you have any queries in relation to the issues raised in this letter.

Yours faithfully,



James Veaney

Head of Electricity Connections and Constraints Management

Signed on behalf of the Authority and authorised for that purpose by the Authority.

⁸ The current version of the electricity distribution licence can be found here: <https://epr.ofgem.gov.uk/Content/Documents/Electricity%20Distribution%20Consolidated%20Standard%20Licence%20Conditions%20-%20Current%20Version.pdf>