

The reasons for our determination on Electricity North West Limited's 24 May 2013 application to charge an unregulated margin on certain contestable connections services

1 Summary

- 1.1 This document contains the reasons for the determination¹, by the Gas and Electricity Markets Authority² of 23 August 2013, on whether Electricity North West Limited (ENWL) a, should be allowed to earn an unregulated margin on certain connections work. ENWL is a Distribution Network Operator³ (DNO).
- 1.2 ENWL submitted a Competition Notice to us on 24 May 2013. This application was made for one Relevant Market Segment (RMS), 'Metered Distributed Generation – Low Voltage work' (DG LV).⁴
- 1.3 We issued a consultation on the ENWL Competition Notice on 6 June 2013.⁵ Having considered the ENWL Competition Notice and the response to our consultation, we have not allowed an unregulated margin in the DG LV RMS. This is because we have not seen sufficient evidence at this stage that customers' interests would be protected if we removed price regulation.
- 1.4 Our determination can be found on our website. This separate document provides reasons for our determination. Appendix 1 of this document summarises 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 DNOs to give customers a 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 customer benefits 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 2009-10 we explained that we had been disappointed with the pace at which competition had developed in the electricity connections market. This was against a backdrop of 87 per cent of metered electricity connections (across Great Britain) being completed by the incumbent DNO, compared to 41 per cent in the gas connections market.⁶
- 2.3 To encourage further competition to develop, we introduced an incentive on DNOs to do all that is within their control to facilitate competition in connection services.⁷ For

¹ Made under Part E of CRC 12 - Licensee's Connection Activities: Margins and the development of competition

² The terms 'the Authority', Ofgem and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

³ As defined in condition 1 of Standard conditions of the Electricity Distribution Licence

⁴ As defined in Part K of CRC 12

⁵ Available from

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=453&refer=NETWORKS/CONNECTNS/COMPINCONN>

⁶ See "Gas and Electricity Connections Industry Review, 2009-10", available from

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=55&refer=Networks/Connectns/ConnIndRev>

⁷ Introduced at Distribution Price Control Review 5 (DPCR5) - further information can be found in our document DPCR5 Final Proposals Incentives and Obligations (REF: 145/09) which is available on the Ofgem website.

the purpose of this incentive we defined nine RMSs in which we considered competition to be viable.⁸ DNOs are able to apply 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 market and consider taking action, including potentially making a referral to the Competition Commission.

- 2.4 We have already considered seven applications made by DNOs - Electricity North West Ltd (July 2011 and January 2013), Northern Powergrid (June 2012), UK Power Networks Ltd (July 2012 and April 2013) Western Power Distribution (October 2012) and Scottish and Southern Energy Power Distribution (January 2013). Our determinations on these applications can be found on our website. We are currently considering one application from Scottish Power Energy Networks which was submitted on 16 August 2013.
- 2.5 ENWL's first application, in July 2011, was for all nine relevant market segments. We allowed an unregulated margin in three of those segments: Metered demand connections EHV and above; Distributed Generations HV/EHV; and Unmetered connections PFI work. ENWL's second application, in January 2013, was for five relevant market segments. We allowed an unregulated margin in three of those segments: Metered demand connections HV; Metered demand connections HV/EHV; and Unmetered connections Local Authority. On both occasions, where we did not allow an unregulated margin in market segments applied for, this was because we considered that we had not seen sufficient evidence that customers' interests would be protected if we removed price regulation.

3 Our assessment

- 3.1 Our determinations on whether to lift price regulation are based on a consideration of our statutory duties and our view on whether ENWL has met two tests: a Legal Requirements Test and a Competition Test.
- 3.2 Our assessment of the Competition Test is a regulatory decision. It 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

- 3.3 ENWL has satisfied the Legal Requirements Test in the RMS as it currently has no enforced breaches of the Competition Act 1998, or of the relevant connections related licence conditions in the 2013-14 regulatory year.

Competition Test

- 3.4 We have assessed whether the Competition Test is met after considering a number of factors, including -
 - actual and potential levels of competition
 - procedures and processes in place to facilitate competition
 - barriers to competition

⁸ 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 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.

- customer awareness of competition, and
 - ENWL’s efforts to open up non-contestable activities to competition.
- 3.5 In making our assessment we considered the nature of the RMS, the analysis provided by ENWL on the current level of competitive activity, as well as information about the processes it has in place to support competition. We also considered the responses to our consultation.⁹
- 3.6 Our assessment is set out in this document and is based on all of the factors listed above. The factors are categorised as follows –
- The actual level of competition in the RMS is discussed under the heading ‘existing competitive activity’.
 - Customer awareness of competition is discussed under the heading ‘customer awareness of and ability to choose competitive alternatives’.
 - Potential levels of competition, procedures and processes in place to facilitate competition, barriers to competition and efforts to open up non-contestable activities to competition are discussed under the heading ‘the potential for further competition’.

Existing competitive activity

- 3.7 We examine, in this section, current levels of activity by ENWL and alternative providers (Independent Connection Providers (ICPs)) in the DG LV segment.
- 3.8 The information in this section is drawn from ENWL’s 24 May 2013 Competition Notice and from subsequent clarifications received from ENWL. The data covers the years 2010-11 and 2011-12, and the first six months of 2012-13.
- The tables below refer to two types of quotes – “ICP quotes” are Point of Connection quotes issued by ENWL, covering only non contestable elements of work. These quotes may be issued to ICPs, customers or to other parties acting on behalf of customers.
 - “ENWL quotes” are all work quotes issued by ENWL, covering contestable and non-contestable elements of work.
- 3.9 The Notice contains data on the value of quotes issued and accepted. In the case of ICP quotes, ENWL told us that the values cover both contestable and non-contestable work, and have been estimated by ENWL using average £/kVA values based on ENWL quotes.
- 3.10 ENWL has described the work it carries out in the RMS as “predominately associated with retro fitting distributed generation to existing premises”. ENWL has reported that during the relevant period, 52 per cent of all accepted ENWL connection offers that involved low voltage DG connections were for zero value (where no chargeable work was considered necessary). A further 44 per cent only contained non-contestable work, and only 4 per cent included any contestable work.
- 3.11 The data reported in this chapter only relates to quotes that contain elements of contestable work.

⁹ A summary of consultation responses can be found at Appendix 1 and the responses are available on our website.

Table 1 Existing competitive activity – DG LV work

Number of competitive alternatives in the RMS	2010-11	2011-12	2012-13 (part)
Number of parties receiving ICP quotes	3	3	1
Number of parties that accepted ICP quotes*	2	2	0
Quotes issued (projects with contestable work)			
Number and average value of ICP quotes issued	5 (£9,500)	3 (£9,800)	1 (£6,400)
Number and average value of ENWL quotes issued	8 (£51,000)	13 (£12,800)	18 (£10,400)
Quotes accepted (projects with contestable work)			
Number and average value of ICP quotes accepted*	2 (£9,100)	2 (£9,700)	0 (N.A)
Number and average value of ENWL quotes accepted	1 (£10,100)	4 (£23,500)	5 (£4,700)

* Includes accepted ICP quotes where the customer eventually asked ENWL to carry out the contestable works.
Source: ENWL Competition Notice May 2013 and data provided by ENWL in response to clarification questions.

3.12 ENWL has stated that two of the four accepted ICP quotes over the two and a half years were later converted into ENWL quotes. This was because the customers involved subsequently commissioned ENWL to carry out the contestable works associated with their connections. Our analysis of the data in ENWL’s notice suggests that these were:

- one project in 2010-11 with a total value of around £16,900; and
- one project in 2011-12 with a total value of around £11,600.

3.13 Table 2 presents the last two rows of the previous tables taking account of this.

Table 2 Analysis of accepted ICP quotes based on the final provider of contestable works – DG LV work

Quotes accepted (projects with contestable work)	2010-11	2011-12	2012-13 (part)
Number and average value of ICP quotes accepted*	1 (£1,300)	1 (£7,800)	0 (N.A)
Number of ICP quotes accepted and then converted into ENWL quotes	1 (£16,900)	1 (£11,600)	
Total number and average value of ENWL quotes accepted (including converted ICP quotes)	2 (£13,500)	5 (£21,100)	5 (£4,700)

* Excludes accepted ICP quotes where the customer eventually asked ENWL to carry out the contestable works.

3.14 We make the following observations based on the data provided:

- This is a small market segment both in terms of the number of jobs and value of the work involved. Only three quotes in 2010-11, six in 2011-12 and five in the first half of 2012-13 contained any contestable work. Of those quotes that contained contestable work, the average value of contestable works was under £5,000.
- In both 2010-11 and in 2011-12 three parties received an ICP quote. One party received an ICP quote in the first half of 2012-13.
- Of the 14 accepted quotes that involved any contestable work, only two (one each in 2010-11 and 2011-12) eventually involved an ICP. The other 12 (86 per cent) were completed by ENWL.
- ENWL's share of the accepted quotes by value was 95 per cent.

Customer awareness of and ability to choose competitive alternatives

3.15 We consider that customers being aware of their choice between competing providers and being able to make informed decisions on which provider to use, are important factors for effective competition.

Promoting awareness of competitive alternatives

3.16 ENWL outlined a number of measures used to inform those potential and actual customers seeking a quote that alternative providers could carry out the contestable elements of a project. These include providing information on its website that explains the concept of contestable and non-contestable work. ENWL's website includes introductory guidance to different types of potential customers and a separate web page — under a heading "Competition in connections" — with text explaining competition in connections and the split between contestable and non-contestable work. This web page provides a link to the Lloyd's Register page listing accredited alternative providers.

3.17 We note the various initiatives (eg seminars and meetings), highlighted by ENWL, which aim to engage with customer and customer groups to explain competition in connections.

3.18 In its Competition Notice, ENWL has stated that even when customers are applying for an all works quote, ENWL "makes explicit reference in its connection offer that part of the work can be carried out by an accredited third party".

3.19 Responses to our consultation from Airgen Renewables Ltd, a developer, have stated that they are aware that competitive alternatives exist.

Transparency of pricing and giving customers the ability to choose

3.20 To be able to make an effective choice, we consider that customers should be able to compare the prices that will be charged by the incumbent DNO with those that may be charged by an alternative provider.

3.21 ENWL has stated that it provides a split between contestable and non-contestable charges on all its quotes. It has also stated that it gives a detailed breakdown of costs on all quotes that are above £10,000 for both contestable and non-contestable charges. An example quote is provided on page 21 of the Competition Notice showing this breakdown.

- 3.22 The figures reported in Section 8 of the Competition Notice suggest that the average value of the ICP quotes issued is below £10,000. ENWL has shown us, as examples, two quotes for work that are under £10,000. In those two quotes, contestable and non-contestable work are identified separately, and, under each heading, charges are broken down to a similar level of detail as in the quote shown on page 21 of the Competition Notice.
- 3.23 ENWL has stated that it includes, in its all works quotes, a statement informing the customer that, if the quote includes contestable work then, the customer can appoint their own contractor to carry that out.
- 3.24 ENWL has stated that, from July 2012, it extended the validity period of its quotes from 90 to 180 days in response to customer requests. ENWL has said that it believes that the 180 day period allows customers time to choose how to proceed in a connection process. This length of time applies to all quotes, irrespective of whether they are quotes for point of connection or for all works. The validity period of an outstanding quotation may be shorter if a new quotation subsequently issued by ENWL interacts with the outstanding quotation.¹⁰ Where such interactivity is identified by ENWL, the acceptance of the new quotation will trigger the withdrawal by ENWL of all unaccepted quotations that interact with the accepted quotation.
- 3.25 ENWL has stated in its Competition Notice that it intends to allow customers in the DG LV segment that have received an all works quote to accept just the non-contestable elements of that quote by the end of the second quarter of 2013. ENWL has since told us that the change has been implemented.
- 3.26 ENWL has told us that distributed generation customers can use a single form to apply for an all works and for a Point of Connection quote, by ticking two separate boxes. ENWL told us that the request to “select only one of these options” in the relevant application form is not enforced.¹¹
- 3.27 Both responses from Airgen say that ENWL’s “dual quote system” is clear and transparent, and allows customers to select either an all works quote or a Point of Connection quote.

The potential for further competition

- 3.28 In this section we consider the potential for further competition to develop, the procedures and processes in place to facilitate competition, whether there are barriers to competition and ENWL’s efforts to open up non-contestable activities to competition.
- 3.29 We recognise that where there appears to be a significant level of competition in a RMS, it has the potential to develop similarly across the RMSs, where levels of competition are currently lower but ENWL’s processes and procedures are similar and the nature of work is broadly equivalent.
- 3.30 In the discussion below we refer at times to potential barriers to competition — generic to GB electricity distribution networks and not specific to ENWL — that have previously been identified by the Electricity Connections Steering Group (ECSG) and by the Competitive Networks Association (CNA).

¹⁰ See pages 15 and 22 of ENWL’s August 2012 ‘Statement of Methodology and Charges for Connection’.

¹¹ See <http://www.enwl.co.uk/docs/connections/application-for-generation-quotation.pdf>.

Availability of guidance and information for ICPs/IDNOs

- 3.31 As identified by the CNA, an alternative provider may be impeded from competing with a DNO if the DNO makes it difficult for the provider to access information that it requires to develop and deliver its own offer. This information can refer, for example, to the DNO's design policy documents, to its codes of practices, method statements or to material specifications.
- 3.32 ENWL has described in its Competition Notice the information available to alternative providers from ENWL's website or from its electronic public library. This includes information on whom to contact to discuss a new job or to submit a new application; information on relevant codes of practice; and information on design policy for industrial supplies.
- 3.33 ENWL's electronic library is password protected. ENWL grants access to ICPs accredited with the National Electricity Registration Scheme (NERS). In response to a request from a consultant, the information will also be made available to other interested parties. The library has a notification screen alerting users to policy changes. ENWL provides CDs of their asset data records free of charge.

Service and response times

- 3.34 Both the ESCG and the CNA have identified the time taken by DNOs in general as a potential barrier to competition. They raised the concern that DNOs may not take the same level of care in dealing with activities that lie outside the scope of their licence obligations on guaranteed service standards (SLC15).
- 3.35 We recognise that unduly long timeframes to handle requests by alternative providers might hamper the ability of alternative providers to compete with ENWL. Uncertainty about these timeframes might also increase the risk — in the eyes of the final customer — of using an alternative provider.
- 3.36 In the context of monitoring activities falling within the guaranteed service standards (SLC15), ENWL states that, as part of its compliance assurance approach, it carries out "quarterly management control checks to ensure that there is no undue discrimination in the provision of non-contestable services to ICPs".
- 3.37 Power Con Ltd, a consultant active in the DG LV market segment, provided a testimonial that was included in ENWL's Competition Notice. According to Power Con, ENWL has been "approachable, helpful, pragmatic and flexible" in dealing with it, and have "the right attitude in trying to help developers actually get connected".

Contractual arrangements for the adoption of assets built by ICPs

- 3.38 The ESCG has raised a concern that the arrangements put in place by DNOs in relation to the adoption of assets built by ICPs may represent a potential barrier to competition. These include the issue of security arrangements (bonds) to protect the DNO against any liability in case there is a fault in the adopted network. This is not specific to ENWL.
- 3.39 In our 21 November 2011 determinations on ENWL's first Competition Notice we raised the point made by some respondents concerning the tripartite agreements required by ENWL and the potential impact these might have on a customer's willingness to use competitive alternatives. In its Competition Notice, ENWL states that it has now developed bilateral adoption agreements and that these have been used on a small number of occasions in 2012.

Inspection and monitoring of assets built by ICPs

- 3.40 The ECSG has raised the issue of inspection and monitoring of assets built by ICPs as a potential barrier to competition. In particular, it questioned the proportionality of the cost and time taken by DNOs to inspect these assets. This is not specific to ENWL.
- 3.41 ENWL has described, in its Competition Notice, that its approach to inspection and monitoring. Its regime has three levels of inspection and "all the main third parties who are active in the ENWL area are on the third and lowest level of inspection".
- 3.42 ENWL has stated that it applies the same inspection and monitoring policy consistently to connections work carried out by ICPs and to connections work carried out by ENWL's staff or by its contractors.
- 3.43 ENWL has developed an IT system to allow ICPs online access to audit results, giving ICPs real time information of audit defects so that rectification can take place without putting energisation dates at risk.
- 3.44 In its Competition Notice, ENWL has reported that it received feedback during 2012 from stakeholders that whilst they supported the three levels of inspection, they considered some of ENWL's thresholds remained onerous. ENWL has highlighted the comment from stakeholders that there were certain activities that had 100 per cent inspection levels, something they thought ought not to be done if they had demonstrated a high quality track record.
- 3.45 Following this feedback, ENWL has stated that it has changed its audit and inspection regime and that this has received favourable feedback from ICPs. ENWL stated in its Competition Notice that it will complete implementation of this revised regime by the end of the second quarter of 2013. ENWL has since told us that it now plans to complete implementation by 30 September 2013.

Arrangements for obtaining land rights

- 3.46 The CNA has identified the process of obtaining land rights when an ICP or IDNO carries out the contestable work as a potential barrier to competition. According to the CNA, DNOs can be slow to initiate the process for securing leases, easements etc, slow in progressing them once begun and the DNOs require all the legal agreements to be in place before they will energise the new connection.
- 3.47 ENWL has stated that it uses standard agreements for easements and land transfers "to speed the process and minimise costs." ENWL also states that it developed alternative agreements for the securing of easements and wayleaves with one IDNO, GTC, following requests from that IDNO to consider an approach it had developed with another DNO.

Consistency of charges

- 3.48 A potential barrier to competition will arise if there are differences between point of connection quotes and all works quotes in the charges set by the DNO for the same non-contestable work. This may place an alternative provider at an undue disadvantage when competing with the DNO for work. This is particularly relevant in the DG LV segment where the average value of contestable works in the ENWL area has been below £5,000 in the period 2010-11 to September 2012.
- 3.49 ENWL has stated that it is consistent in its pricing between all works quotes and Point of Connection quotes. ENWL has stated that this consistency applies in

particular to its “inspection and monitoring charges” where it applies the same charges irrespective of whether these charges are in the context of an all works quote — and therefore where it is ENWL’s work which is being inspected — or in the context of Point of Connection quotes where the work is carried out by an alternative provider. This is provided that the relevant ICP is at the same (lowest) level of inspection regime that is applied to ENWL’s own work. ENWL has stated that most ICPs are at that level.

- 3.50 There will be differences in the charges set out in a Point of Connection quote and in the non-contestable elements of an all works quote to reflect differences in the two processes. ENWL described these as “transactional charges associated with Competition in Connections such as design approval and issuing adoption agreements”.

Scope of contestable work

- 3.51 Connections works are split between works that are contestable (competitive) and those that are non-contestable (can only be completed by the DNO).
- 3.52 In our December 2011 consultation, on expanding the scope of contestable activities, we stated our belief that opening up non-contestable activities to competitors may provide further opportunities and incentives for competition to develop in the connections market. This is because it reduces competitors’ reliance on DNOs to provide essential services, and it increases the scope of works for which competitors can compete.
- 3.53 We consider that DNOs should engage with the industry to consider where it is possible to extend contestability further.
- 3.54 ENWL reports on its efforts to expand the scope of contestable work –
- ENWL has stated that since 2012 it allows “suitably accredited third parties to make live low voltage connections to [ENWL’s] existing network and carry out the high voltage jointing work associated with connections.”
 - Determining the point of connection is currently a non-contestable activity. ENWL stated that it has completed trials with three ICPs on determining their own point of connection with mixed success. ENWL is due to start a new trial where the ICP is also to determine the point of connection, build it to a standard design and self connect.

Our conclusions

- 3.55 In making our determination we have taken account of the evidence provided by ENWL and the views expressed in responses to our consultation.
- 3.56 We note that ENWL has taken a number of steps to facilitate the development of competition across all RMSs in its area, including the DG LV RMS. The two respondents to our consultation (both from the same generation developer) did not identify any barriers to competition in ENWL’s area, and were appreciative of ENWL’s practices. The same sentiment is echoed in the set of testimonials which ENWL submitted in its Competition Notice.
- 3.57 Our analysis of data on competitive activity provided by ENWL shows that, of the 48 quotes issued for connections that required contestable works in the two and a half years to September 2012, only nine were “contestable works only” or ICP quotes.

- 3.58 14 connection quotes requiring contestable works were accepted in the same period. Of these, ENWL completed the contestable works in 12 (86 per cent). The 12 connections completed by ENWL represented 95 per cent by value of the segment (defined as new connections with contestable work).
- 3.59 Three parties were issued ICP quotes in the DG LV RMS in each of the years 2010-11 and 2011-12. Some of these ICP quotes were issued to customers, rather than ICPs. While it seems likely that any customer that receives an ICP quote might intend to seek quotes for contestable works from ICPs, the Competition Notice does not provide information on whether customers actually did so.
- 3.60 We also remain concerned that the small volumes and low values of projects in this RMS may not be attractive to competitors. As such, and on the balance of available evidence, we are not convinced that competition has developed to the extent that customers' interests would be protected in the absence of price regulation.
- 3.61 Although we are satisfied that ENWL has taken appropriate steps within its powers to remove barriers to competition in this RMS, we have come to the conclusion that the small volumes and low values of projects in this RMS have affected the development of competition, making it insufficiently attractive to competitors and, in turn, limiting the choice available to customers. We therefore do not consider that at this point the Competition Test has been satisfied in this RMS.

4 Next steps

- 4.1 We will continue to regulate the price ENWL charges in respect of all of the connections services it provides in the DG LV RMS. In respect of contestable connections services (fully funded by the customer), this means that ENWL may continue to charge the regulated margin (fixed at four per cent) allowed by Charge Restriction Condition (CRC) 12.
- 4.2 ENWL may reapply to have price regulation lifted by providing us with further Competition Notices. It can do this at any time from four months after the date of our determination and up to 31 December 2013. We would encourage ENWL, and any other DNOs considering making an application, to consider carefully the reasons for our decision provided in this document.

Appendix 1 – Responses to our consultation on ENWL’s 24 May 2013 Competition Notice

- 4.3 On 6 June 2013 we issued a consultation seeking views from interested parties on ENWL’s Competition Notice. This consultation and the responses we received have been published on our website.
- 4.4 We received responses from two individuals, both from the same organisation. A summary of both responses is provided below.

Airgen Renewables Ltd

- 4.5 Airgen is a renewable energy developer and connections customer operating in the ENWL DSA.
- 4.6 One respondent from Airgen made the following points:
- Airgen is aware that competitive alternatives to ENWL exist.
 - ENWL’s new “2-quote policy”, whereby a customer can choose to accept either an all works quote or just the non-contestable elements of that quote has improved customers’ ability to choose.
 - ENWL “reflect best practise – managers easily approachable, flexible in processes”
 - There is scope for competitors to grow their market share.
- 4.7 The other respondent from Airgen made very similar points to the first respondent:
- Airgen is aware that competitive alternatives to ENWL exist.
 - ENWL’s new “dual-quote system”, has improved customers’ ability to choose.
 - ENWL are “very approachable and flexible in their practices”.
 - There is scope for competitors to enter the market, although “it may take some time before another entrant could become truly competitive with ENWL”.