

## **The reasons for our determination on Western Power Distribution's 31 October 2013 application to charge an unregulated margin on certain contestable connections services**

### **1 Summary**

- 1.1 This document contains the reasons for the determination made by the Gas and Electricity Markets Authority<sup>1</sup> on 25 February 2014, under Part E of CRC 12<sup>2</sup>, on whether Western Power Distribution (WPD), a Distribution Network Operator<sup>3</sup> (DNO), should be allowed to earn an unregulated margin on certain connections work.
- 1.2 On 31 October 2013 WPD submitted Competition Notices in respect of its licensed distribution networks -
- Western Power Distribution (South West) plc,
  - Western Power Distribution (South Wales) plc,
  - Western Power Distribution (East Midlands) plc, and
  - Western Power Distribution (West Midlands) plc
- 1.3 The Notices relate to the Metered Distributed Generation High Voltage and above (DG HV EHV) work Relevant Market Segment (RMS).
- 1.4 We issued a consultation on the WPD Competition Notices on 3 December 2013.<sup>4</sup> Having considered the Competition Notices and the responses to our consultation, we have allowed an unregulated margin in the Metered Distributed Generation High Voltage and above RMS in the South West Distribution Service Area (DSA) only. We have not allowed an unregulated margin in the other DSAs because we have not seen sufficient evidence at this stage that customers' interests would be protected if we removed price regulation.
- 1.5 Our determination can be found on our website.<sup>5</sup> This 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.

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

<sup>2</sup> CRC 12 Licensee's Connection Activities: Margins and the development of competition

<sup>3</sup> As defined in condition 1 of Standard conditions of the Electricity Distribution Licence

<sup>4</sup> Available from

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

<sup>5</sup> <http://www.ofgem.gov.uk/Networks/Connectns/CompinConn/Pages/CompinCnnectns.aspx>

- 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.<sup>6</sup>
- 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.<sup>7</sup> For the purpose of this incentive we defined nine RMSs in which we considered competition to be viable.<sup>8</sup> DNOs have been able to apply to have price regulation lifted in an RMS where they can demonstrate that competition is effective. We made it clear to DNOs that where effective competition has not developed by 31 December 2013, we would review the market and consider taking action, including making a referral to Competition Commission.<sup>9</sup> We will be setting out our approach to reviewing markets where competition has not been effective at the start of the summer.
- 2.4 This is WPD's second application. We have already issued our determinations on nine applications made by DNOs - Electricity North West Limited (on 21 November 2011, 10 May 2013 and 23 August 2013), Northern Powergrid (on 26 October 2012), UK Power Networks (on 29 October 2012 and 15 August 2013), Western Power Distribution (on 25 February 2013), Scottish and Southern Energy Power Distribution (on 29 April 2013) and Scottish Power Energy Networks (on 13 December 2013). These can be found on our website. We are currently considering four applications submitted in December 2013.

### **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 WPD 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.
- 3.3 We are required to make separate determinations in each of WPD's four licensed distribution service areas (DSAs).

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<sup>6</sup> 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>

<sup>7</sup> 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 at:

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=348&refer=NETWORKS/ELECDIST/PRICECNTRLS/DPCR5>

<sup>8</sup> 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.

<sup>9</sup> On 1 April 2014, the new Competition and Markets Authority will bring together Competition Commission with the competition and certain consumer functions of the Office of Fair Trading (OFT).

### Legal Requirements Test

- 3.4 WPD has satisfied the Legal Requirements Test in all four DSAs as it currently has no enforced breaches of the Competition Act 1998 or of the relevant connections related licence conditions in the 2013-2014 regulatory year<sup>10</sup>.

### Competition Test

- 3.5 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
  - customer awareness of competition, and
  - WPD's efforts to open up non-contestable activities to competition.
- 3.6 In making our assessment we considered the nature of the RMS, the analysis provided by WPD on the current level of competitive activity in each of its DSAs, 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 WPD's DSAs.<sup>11</sup>
- 3.7 Our assessment is set out in this document and is based on all of the factors listed above. 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*

- 3.8 In its Competition Notices WPD provides data on competitive activity in the DG HV and EHV RMS for each DSA.
- 3.9 WPD's Notices refer to three types of quotations -
- A WPD quotation is one issued by WPD to carry out all the works, contestable and non-contestable, associated with a new connection.
  - An ICP quotation is one issued by WPD to carry out non-contestable work only where an ICP carries out the contestable work.
  - An IDNO quotation is one issued by WPD to carry out non-contestable work only where an IDNO will adopt the assets and where the contestable work is carried out by an ICP or IDNO.
- 3.10 In this document, we may refer to WPD quotations as "full works" quotations and ICP quotations and IDNO quotations jointly as Point of Connection (POC) quotations.

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<sup>10</sup> Standard Licence Conditions 12.6(c), 15, 15A and 19

<sup>11</sup> A summary of consultation responses can be found at Appendix 1 and the responses are available on our website.

3.11 WPD has presented the following information on competitive activity within each DSA -

- The number of parties that received, and the number that accepted, a POC quotation (April 2011 to July 2013).
- The number of full works and POC quotations issued and accepted (April 2011 to July 2013).
- The number of connections completed split by whether it was completed by WPD, an ICP or an IDNO (April 2011 to July 2013).
- The value of non-contestable work associated with full works and POC quotations accepted (April 2012 to July 2013 only).
- The export capacities associated with full works and POC quotations accepted (April 2013 to July 2013 only).
- The export capacities associated with full works, ICP and IDNO connections completed (April 2013 to July 2013 only).

3.12 The tables below present the data for each DSA.

**Table 1: Number of parties that received POC quotations (April 2011-July 2013)**

<b>Distribution Service Area</b>	<b>2011-12</b>	<b>2012-13</b>	<b>April 2013 to July 2013*</b>
WPD (South West) plc	11	21	33
WPD (South Wales) plc	4	11	20
WPD (East Midlands) plc	9	15	23
WPD (West Midlands) plc	6	8	9

Source: WPD Competition Notices October 2013 and subsequent clarifications received from WPD

\* Data relating to April-July 2013 are not comparable to previous years

**Table 2: Number of parties that accepted POC quotations (April 2011-July 2013)**

<b>Distribution Service Area</b>	<b>2011-12</b>	<b>2012-13</b>	<b>April 2013 to July 2013*</b>
WPD (South West) plc	5	19	8
WPD (South Wales) plc	1	7	7
WPD (East Midlands) plc	2	10	4
WPD (West Midlands) plc	1	4	1

\* Data relating to April-July 2013 are not comparable to data on previous years

3.13 The data on the number of parties receiving and accepting POC quotes in the period from April 2013 to July 2013 are not comparable to the data in previous years. In response to a clarification question, WPD informed us that in previous periods, parties who “had only made a single application” were grouped together as one entity (“one off customer”). WPD added that this was “in line with the data in our previous notice”. However, in the most recent period (April – July 2013), WPD has separated these out to show the variety and number of new parties applying”. All but one of the parties receiving POC quotes in the relevant period received ICP quotations.<sup>12</sup>

<sup>12</sup> WPD’s application had stated that one IDNO quotation was issued in the East Midlands DSA in 2012-13. Following submission, WPD told us that the quote in question was an ICP quote, not an IDNO quote. Separately WPD also told us that 33 parties, rather than 32 as stated in the Notice, had received POC quotes in the South West DSA between April and July 2013. We have taken these changes into account in our analysis.

**Table 3: Existing competitive activity – Quotations accepted (April 2011-July 2013)**

	<b>2011-12</b>	<b>2012-13</b>	<b>April 2013- July 2013</b>
<b>WPD (South West) plc</b>			
Total number of accepted quotes	297	503	64
WPD share of accepted quotes	93%	81%	81%
ICP share of accepted quotes	7%	19%	19%
IDNO share of accepted quotes	-	-	-
<b>WPD (South Wales) plc</b>			
Total number of accepted quotes	117	192	32
WPD share of accepted quotes	97%	90%	72%
ICP share of accepted quotes	3%	10%	28%
IDNO share of accepted quotes	-	-	-
<b>WPD (East Midlands) plc</b>			
Total number of accepted quotes	27	97	27
WPD share of accepted quotes	93%	81%	81%
ICP share of accepted quotes	7%	19%	19%
IDNO share of accepted quotes	-	-	-
<b>WPD (West Midlands) plc</b>			
Total number of accepted quotes	25	84	19
WPD share of accepted quotes	96%	88%	95%
ICP share of accepted quotes	4%	12%	5%
IDNO share of accepted quotes	-	-	-

**Table 4: Existing competitive activity – Connections completed (April 2011-July 2013)**

	<b>2011-12</b>	<b>2012-13</b>	<b>April 2013- July 2013</b>
<b>WPD (South West) plc</b>			
Total number of completed connections	116	142	16
WPD share of completed connections	96%	83%	50%
ICP share of completed connections	4%	17%	50%
IDNO share of completed connections	-	-	-
<b>WPD (South Wales) plc</b>			
Total number of completed connections	12	41	3
WPD share of completed connections	100%	85%	67%
ICP share of completed connections	0%	15%	33%
IDNO share of completed connections	-	-	-
<b>WPD (East Midlands) plc</b>			
Total number of completed connections	17	43	8
WPD share of completed connections	100%	79%	38%
ICP share of completed connections	-	21%	63%
IDNO share of completed connections	-	-	-
<b>WPD (West Midlands) plc</b>			
Total number of completed connections	12	14	5
WPD share of completed connections	100%	93%	40%
ICP share of completed connections	-	7%	60%
IDNO share of completed connections	-	-	-

**Table 5: Existing competitive activity – Analysis of non-contestable charges in accepted quotes (April 2012-July 2013)**

	<b>2012-13</b>	<b>April 2013- July 2013</b>
<b>WPD (South West) plc</b>		
Total value of non-contestable work in accepted quotes	£8,417,636	£7,226,186
Average non-contestable value of WPD accepted quotes	£16,505	£73,645
Average non-contestable value of ICP accepted quotes	£17,733	£283,054
Average non-contestable value of IDNO accepted quotes	-	-
<b>WPD (South Wales) plc</b>		
Total value of non-contestable work in accepted quotes	£33,358,180	£2,951,497
Average non-contestable value of WPD accepted quotes	£110,050	£41,755
Average non-contestable value of ICP accepted quotes	£753,662	£221,237
Average non-contestable value of IDNO accepted quotes	-	-
<b>WPD (East Midlands) plc</b>		
Total value of non-contestable work in accepted quotes	£3,312,711	£1,210,748
Average non-contestable value of WPD accepted quotes	£33,302	£32,867
Average non-contestable value of ICP accepted quotes	£40,111	£97,533
Average non-contestable value of IDNO accepted quotes	-	-
<b>WPD (West Midlands) plc</b>		
Total value of non-contestable work in accepted quotes	£1,357,659	£163,997
Average non-contestable value of WPD accepted quotes	£13,790	£8,853
Average non-contestable value of ICP accepted quotes	£33,717	£4,635
Average non-contestable value of IDNO accepted quotes	-	-



**Table 6: Existing competitive activity – Analysis of quotations accepted by export capacity (April 2013-July 2013)**

<b>Accepted quotations</b>	<b>South West</b>	<b>South Wales</b>	<b>East Midlands</b>	<b>West Midlands</b>
Total export capacity (MVA)	213.0	202.7	141.9	15.1
Number of accepted quotations	64	32	27	19
<b>Average capacity</b>				
Average WPD capacity (MVA)	2.1	3.5	3.1	0.8
Average ICP capacity (MVA)	8.7	13.6	14.7	0.5
<b>Share of capacity</b>				
WPD share of capacity	51%	40%	48%	97%
ICP share of capacity	49%	60%	52%	3%

**Table 7: Existing competitive activity – Analysis of completed connections by export capacity (April 2013-July 2013)**

<b>Completed connections</b>	<b>South West</b>	<b>South Wales</b>	<b>East Midlands</b>	<b>West Midlands</b>
Total export capacity (MVA)	58.8	11.6	72.5	10.4
Number of completed connections	16	3	8	5
<b>Average capacity</b>				
Average WPD capacity (MVA)	2.6	0.1	1.5	1.7
Average ICP capacity (MVA)	4.7	11.5	13.6	2.3
<b>Share of capacity</b>				
WPD share of capacity	36%	1%	6%	34%
ICP share of capacity	64%	99%	94%	66%

3.14 We make the following observations on the levels of competitive activity in this RMS based on the data in the tables above -

- A number of parties have received and accepted POC quotations in all four DSAs over the period covered by the data. The numbers in the West Midlands DSA are

smaller than in the other DSAs, reflecting the smaller size (in terms of completed connections) of the RMS in this area.

- WPD enjoys a relatively high share of the market in terms of the number of quotations accepted in all four DSAs. For the most recent full year for which data are provided (April 2012 – March 2013), WPD's share of accepted quotations was 81 per cent in the South West DSA, 90 per cent in the South Wales DSA, 81 per cent in the East Midlands DSA and 88 per cent in the West Midlands DSA. The number of accepted quotations was highest in the South West DSA which was also the busiest DSA in terms of volume of work. In this DSA ICPs accepted 94 out of a total of 503 accepted quotations in 2012-13.
- In terms of the number of completed connections, the picture is broadly similar. WPD's shares in each DSA for the full year April 2012 – March 2013 are 83 per cent in the South West DSA, 85 per cent in the South Wales DSA, 79 per cent in the East Midlands DSA and 93 per cent in the West Midlands DSA. WPD's share of completed connections is lower in all four DSAs in the four months from April 2013 to July 2013.
- Our analysis of the value of non-contestable works in each area shows that the average values of non-contestable works in accepted ICP quotations are generally higher than those in accepted WPD quotations. The difference is least pronounced in the South West DSA in 2012-2013. The analysis of accepted quotes by capacity shows that the average capacities of accepted ICP quotations are significantly higher than the average capacities of accepted WPD quotations in the South West, South Wales and East Midlands DSAs. In the West Midlands DSA, the average capacity of WPD quotations is higher. However, we note that the data on capacities only relate to a small number of quotations accepted in a four month period (April 2013 to July 2013).
- The average capacities of completed connections follow a similar pattern. The average capacities of accepted ICP quotations are higher than those of accepted WPD quotations in all four DSAs, with the smallest difference in the West Midlands DSA.

#### 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 WPD outlines a number of actions it has taken to make potential customers aware that alternative providers may carry out the contestable elements of a project. These include -
- Its website includes an area dedicated to providing information on competition in connections. A link to this page is prominently provided on the "Connections" section of the website. The website alerts potential connectees that some of the work associated with the new connection can be carried out by independent connections providers. A link to the list of ICPs maintained by Lloyd's Register is also provided.
  - The website includes a link to a leaflet "Competition in Connections", which explains the process of choosing an alternative provider when making a new connection to WPD's network. According to WPD's application, a copy of this leaflet is included in every quotation issued.

- The website includes a link to an extract from WPD’s connections charging statement showing indicative charges for various services relating to competition in connections.
- A new online application system for full works quotations was launched on 11 November 2013, to add to the existing online system for POC applications. According to WPD, this new system allows connections customers to choose between “competitive and non-competitive enquiries”.
- WPD has provided guidance to its customer contact centres on competition in connections so that they can answer related questions from customers.
- To demonstrate the extent of awareness of competition amongst its DG customers, WPD reports the results of its annual DG customer survey conducted with customers that requested quotations and those that connected to its network. An overwhelming majority of respondents (between 84 and 97 per cent, out of 177 surveyed) in the DG HV and EHV RMS across all four WPD DSAs were aware that “competitive connection providers could also quote for competitive work”.

3.17 Respondents to our consultation generally agreed with WPD’s view that customers are aware of competitive alternatives.

*Transparency of pricing and giving customers the ability to choose*

3.18 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.

3.19 WPD states that its new connection offer breakdown provides customers with a “structured and transparent split of elements of work” so that they can understand the price for each of these elements. The breakdown is split into the following -

- Fees. This includes labour charges for design and assessment, design approval and obtaining land rights.
- Works. This covers the installation of new assets (substations, cables) split by voltage level. This is broken down further into contestable and non-contestable works.
- Reinforcement. This includes any contributions chargeable to the customer in relation to the cost of reinforcements to the existing WPD network. This is broken down by asset type, and includes the proportion of the cost of the relevant asset that the customer is paying for.
- Summary and other charges. Apart from a summary of the charges listed above, this section includes other charges where these are payable. This might include charges or refunds to the customer under the Electricity (Connection Charges) Regulations 2002.

3.20 Appendix 8 of WPD’s application includes a sample full works connection quotation that contains the details listed above.

3.21 In our consultation, we had noted WPD’s intention to develop and launch “dual offer quotes” on a trial basis for “large demand and generation connection schemes”. Dual offer quotes are quotations where the customer can choose to accept either the full works option or a POC option. Once accepted, a full works quote cannot subsequently be converted into a POC quote. We have since been informed by WPD that, from 30 December 2013, dual offer quotations are being issued in relation to all new EHV distributed generation connection requests.

- 3.22 The sample quotation in Appendix 8 states that the quotation is valid for a period of 90 days from the date of issue.
- 3.23 Respondents to our consultation said that WPD's quotations are clear and transparent.

*The potential for further competition*

- 3.24 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 WPD's efforts to open up non-contestable activities to competition.
- 3.25 In the discussion below we refer at times to potential barriers to competition — generic to GB electricity distribution networks and not specific to WPD — that have previously been identified by the Electricity Connections Steering Group (ECSG) and by the Competitive Networks Association (CNA).

*Availability of guidance and information for ICPs/IDNOs*

- 3.26 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.
- 3.27 WPD describes in its Competition Notices the actions it has taken to address this potential concern.
- 3.28 WPD's website provides a range of information for customers and potential competitors. These include application forms, process documents, copies of national framework documents, technical specifications, guidance for seeking land rights, and live jointing and adoption agreements.
- 3.29 WPD's "Crown Internet Routing & Tracking" (CIRT) system allows parties to apply for new POC quotations and track the progress of such enquiries online. This system also allows independent providers to submit documents such as design approval, final works and energisation requests online. It also displays a daily updated status of various activities relating to each scheme. According to WPD's Notices, since the launch of the CIRT system in November 2012, over 1300 enquiries have been raised through this system and 25 companies, 22 of whom are either ICPs or IDNOs, are currently signed up to use it.
- 3.30 WPD has published two sets of resources for users wishing to connect new distributed generation to its network. The "Generation Capacity Map" provides an estimate of the substation capacity available for new distributed generation connecting to WPD's HV networks (11kV and 6.6kV) at different points on its network. This map is searchable by postcode area. A separate set of EHV constraint maps highlight, for each DSA, the parts of the WPD EHV network (33kV and 132kV/275k lines) that are close to its thermal or voltage limits, implying the need for reinforcement in the event of increased power flows.
- 3.31 WPD maintains a separate website containing links to technical policy documents, including construction and design standards for ICPs and IDNOs. This website is accessible by registered users only.

- 3.32 WPD provides free geographic asset information through a web interface (WPDWebMap) that allows ICPs and others to request plans for a specific part of WPD's network. According to WPD, plans requested through this system will be "returned to the user via email, usually in a matter of minutes".
- 3.33 Users that require "large volumes of plans and/or further asset information" can use an alternative WPD service (EMU Asset Data). This service offers users free access to raw data on WPD assets from the WPD EMU geographic information system. Users can view the data using "optional WPD viewing software" for a fee.
- 3.34 Respondents did not express a view on the availability of guidance and information for ICPs/IDNOs.

*Service and response times*

- 3.35 Both the ECSG and the CNA have identified the time taken by DNOs in general as a potential barrier to competition. More specifically, 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).
- 3.36 We recognise that unduly long timeframes to handle requests by alternative providers might hamper the ability of alternative providers to compete with WPD. And uncertainty about these timeframes might increase the risk — in the eyes of the final customer — of using an alternative provider.
- 3.37 WPD states that it "endeavours to carry out activities as soon as practicable rather than just meet the timescales" set out in the Standard Licence Condition 15 (SLC 15) of their Distribution Licence. WPD also sets additional targets for staff "against connection activities to ensure service levels are maintained".
- 3.38 WPD teams are set a target of responding to connection requests (competitive or otherwise) within two working days of receipt. Internal targets are also set for processes relating to land rights. WPD applies SLC15 standards on a voluntary basis for contestable works that are carried out by WPD at the request of an independent provider.
- 3.39 WPD states that, for new DG connections, it often receives requests for "novation of connection offers and connection agreements" due to changes in ownership or funding sources of the connectee. WPD has developed standard template agreements for such scenarios that are aimed at speeding up this process.
- 3.40 The Notices also provides examples of assistance provided by WPD to ICPs operating in its area to help them meet the 31 March 2013 deadline for connecting new Photovoltaic (PV) generation schemes (at higher subsidy rates) to WPD's network.
- 3.41 WPD states that it has received feedback from customers through its annual DG customer satisfaction surveys carried out in a way that allows comparison with the Broad Measure of Customer Satisfaction incentive arrangements for DNOs. According to the Notices, WPD's average customer satisfaction score amongst DG HV EHV customers increased from 8.64 (out of 10) in 2012 to 8.82 in 2013. In addition, it states that the four WPD DSAs achieved the highest connection customer satisfaction scores amongst all DNO areas in the current year (up to September 2013).
- 3.42 Respondents to our consultation were, in general, happy with the service provided by WPD. One respondent said "WPD's procedures and processes definitely reflect best practice."

### *Contractual arrangements for the adoption of assets built by ICPs*

- 3.43 The ESCG has identified that the arrangements put in place by DNOs in relation to the adoption of assets built by ICPs are a potential barrier to competition. In particular, the ESCG raised 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 WPD.
- 3.44 WPD states that it has updated its "LV Network Access And Adoption Agreement" by extending it to cover live LV and HV jointing work on the existing distribution system, and introducing a cap on the potential liability of ICPs in relation to assets installed by ICPs and adopted by WPD. The application also states that "to date WPD has not requested a bond from an ICP".
- 3.45 In our consultation, we noted that WPD intended to replace its trilateral adoption agreement for metered connection schemes (involving WPD, the ICP and the connectee), with a new bilateral agreement between WPD and the ICP. Subsequently, WPD informed us that a new bilateral agreement was introduced on 3 February 2014. WPD explained that a draft version of this bilateral agreement had been presented to stakeholders at a workshop held on 19 November 2013. WPD explained that the agreement had been amended following the workshop to take account of feedback received from ICPs.
- 3.46 One respondent, whose response is confidential, said that on at least one occasion, WPD had asked a customer to agree to indemnify WPD "in perpetuity" against any liability arising out of assets built or civil works undertaken by an ICP. The respondent added that WPD had subsequently withdrawn this condition when challenged. WPD responded by saying that they are aware of one such instance where an outdated excavation agreement was issued in error, and that it had apologised to the party involved.

### *Inspection and monitoring of assets built by ICPs*

- 3.47 The ESCG 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 WPD.
- 3.48 WPD has told us that it follows our inspection regime. However, it believes that there is a need for the inspection regime to be reviewed, as it was originally only intended for "underground fed, green field housing sites". WPD has been reviewing its inspection and monitoring regime, and is "planning to consult with stakeholders next year".
- 3.49 The confidential response cited problems with WPD's system for inspection of assets built by ICPs. In particular, the respondent claimed that WPD has changed its requirements after the ICP had built assets, even though these assets were built to a design that had been previously approved by WPD. WPD said "unless there is a specific issue with a piece of equipment which for example has been withdrawn due to a safety issue then we would not change the [requirement] for an ICP on a scheme which has been approved. Where the WPD specification changes after design approval we would allow the ICP to continue to [use] the previously approved design and apply the new specification to future designs."
- 3.50 Other respondents did not raise specific concerns about WPD's inspection and monitoring processes.

### *Arrangements for obtaining land rights*

- 3.51 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 and easements etc and slow in progressing them once begun. The DNOs require all the legal agreements to be in place before they will energise the new connection.
- 3.52 WPD has told us that it has jointly developed, with an IDNO, a process that would allow the IDNO to take the lead on obtaining land rights and legal permissions. According to WPD, "3 IDNOs have signed up and the other 2 are in the process of doing so".
- 3.53 WPD has developed a guidance document that explains the processes for obtaining legal permissions, including sample versions of documents that WPD would require.
- 3.54 Respondents to our consultation did not express a view on this.

### *Consistency of charges*

- 3.55 A potential barrier to competition will arise if there are differences between POC quotes and full 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.
- 3.56 WPD has told us that it "does not discriminate between class of customer". The breakdown of charges provided in all WPD quotations would allow customers and independent providers to compare the cost of non-contestable services offered by WPD. Charges associated with competition in connections, such as inspection, design approvals etc, are clearly demarcated in competitive WPD quotations.
- 3.57 The confidential response claimed that WPD applied an inconsistent charging policy to full works quotes and POC quotes. The respondent claimed that customers seeking a connection from WPD would only be asked to pay a part of the charges for "upstream network reinforcement" (under apportionment rules). If the same connection were delivered through an ICP, the apportionment would not apply and the customer would have to pay "100% of the upstream reinforcement works". In response to a clarification question, WPD told us that it applied the same apportionment percentages for full works quotes and POC quotes as long as the same load characteristics were used in both applications. WPD added that its "structure ensures that in most cases the WPD Planner designing and costing the competitive POC request will normally be the same Planner who designs the non-competitive application. This is due to each team having responsibility for an area of the network. This approach ensures that the design and costing of the non-contestable elements of both are the same save for the costs of design approval and inspections on a CiC<sup>13</sup> quotation."
- 3.58 Another respondent said that WPD's charges were consistent across all works and POC quotes, and the "two sets of charges are easily comparable".

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<sup>13</sup> Competition in Connections. In this document, we refer to CiC quotations as POC quotations.

### *Scope of contestable work*

- 3.59 Connections works are split between works that are contestable (competitive) and those that are non-contestable (can only be completed by the DNO).
- 3.60 In our December 2011 consultation on expanding the scope of contestable activities we argued 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 would reduce competitors' reliance on DNOs to provide essential services and it would increase the scope of works for which competitors can compete.
- 3.61 We consider that DNOs should engage with the industry to consider where it is possible to further extend contestability.
- 3.62 According to WPD's Notices, live jointing works on existing WPD LV underground and overhead mains and service cables is a contestable activity. WPD reports on its efforts to further expand the scope of contestable work. WPD is running two trials under which independent providers would be able to carry out jointing to existing WPD HV networks.
- 3.63 The first trial involves ICPs working to WPD's own "Distribution Safety Rules" (DSRs). This trial was initiated in September 2012 following a seminar. WPD provided training to staff of interested providers. At the time of submission of WPD's application, four independent providers were signed up to an agreement which allows them to work under the trial. They may choose only to carry out LV works under the agreement but have the option to work on the HV trial.
- 3.64 The other trial involves ICPs working to their own DSRs. According to WPD's application, this "removes the need for ICPs to require a WPD authorisation and subsequent annual field checks for their staff". There are eight ICPs currently signed up to an agreement which allows them to work under the trial. Again, they may choose only to carry out LV works under the agreement but have the option to work on the HV trial.
- 3.65 One respondent to our consultation said that "WPD have worked hard to open up" competition in its DSAs.

### *Our conclusions*

- 3.66 In making our determinations we have taken account of the evidence provided by WPD and the views expressed in responses to our consultation.
- 3.67 We note the steps that WPD has taken to address concerns about barriers to competition. In particular, we note that WPD -
- has taken steps to promote awareness of competition amongst prospective customers, including WPD's website which provides a range of information for customers and competitors.
  - along with an IDNO, has introduced a new process for securing land rights.
  - has taken steps to extend competition by expanding the list of services that are contestable.
  - has introduced the dual offer quotation for EHV generation, which should make it easier for these customers to choose an alternative connections provider.



- has introduced a new bilateral asset adoption agreement for ICPs wishing to compete with WPD.

- 3.68 Three out of four respondents to our consultation were positive about the steps that WPD had taken to address any barriers to competition, and expressed support for WPD's application in all four DSAs. One respondent, who wished to remain anonymous, took a different view and raised concerns in a confidential response about possible barriers to competition in the WPD DSAs. We gave WPD an opportunity to respond by sharing with them a summary of the relevant sections of the confidential response. However, we recognise that such an anonymised summary may have made it difficult for WPD to respond in detail on the points highlighted.
- 3.69 We are satisfied, based on the evidence provided, that the steps taken by WPD have generally addressed previously identified barriers to competition. However, we note that WPD has not introduced "dual offer quotes" for HV distributed generation connections.
- 3.70 In the South Wales, East Midlands and West Midlands DSAs, WPD retains a high share of the RMS. We see lower levels of activity by alternative providers in these DSAs compared to the South West DSA, reflecting the smaller size of the RMS in these DSAs. We also note the consistent difference between the average values of non-contestable works in accepted ICP and WPD quotations. This suggests that alternative providers in these areas have tended to be more successful in larger projects, assuming the value of non-contestable works is related to the size of the project. There is also little prospect of "entry from below", given that WPD has not yet demonstrated that effective competition exists in the DG Low Voltage RMS. Based on the evidence provided, we are not convinced that all customers in these DSAs would be protected by competition, in this RMS, in the absence of price regulation.
- 3.71 WPD also retains a high share of the RMS in the South West DSA. However, we can also see evidence of significant activity by alternative providers. In 2012-13, parties accepted a large number of POC quotations (94 out of 503). This is high relative to other DNO areas and RMSs where we have lifted price regulation in the past. We also note that 19 different parties accepted POC quotations in the same year. In terms of the average values of non-contestable work, there was little difference between accepted ICP quotations and accepted WPD quotations in 2012-2013. We also note that the average value of non-contestable charges in ICP quotes accepted in 2012-13 was significantly lower than in April 2013-July 2013. This suggests that ICPs are having some success in competing against WPD for all types of DG HV EHV work in this DSA. On balance, we are satisfied that WPD's prices in the South West DSA would be constrained effectively by competition, and that all customers in this RMS would be protected by competition in the absence of price regulation.

## 4 Next steps

### Where the Competition Test has been satisfied

- 4.1 From the date of our determination 25 February 2014, we will no longer regulate the prices WPD may charge in respect of any contestable connection services (fully funded by the customer)<sup>14</sup> in the Distributed Generation HV and EHV RMS in the South West DSA.

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<sup>14</sup> Under the DNOs connection charging methodologies, connections work which is defined as 'reinforcement' or is over and above the minimum scheme may be part funded by the customer and the company.

- 4.2 In respect of this RMS and DSA, WPD will submit to us annually a report explaining any changes that have occurred in the RMS since the date of the determination.
- 4.3 We reiterate that, as part of our ongoing work, we have a general duty to keep the electricity market under review and we will take seriously any breach of competition law and/or licence obligations.

Where the Competition Test has not been satisfied

- 4.4 We will continue to regulate the price WPD charges in respect of all of the connections services it provides in the Distributed Generation HV and EHV RMS in the South Wales, East Midlands and West Midlands DSAs. In respect of contestable connections services (fully funded by the customer), this means that WPD may continue to charge the regulated margin (fixed at four per cent) allowed by Charge Restriction Condition (CRC) 12.

## **Appendix 1 – Responses to our consultation on WPD’s 31 October 2013 Competition Notices**

- 4.5 On 3 December 2013 we issued a consultation seeking views from interested parties on WPD’s Competition Notices. We received four responses, including one confidential response. Our consultation and the non-confidential responses we received have been published on our website.
- 4.6 We received non-confidential responses from:
- Powercon (UK) Ltd
  - TUSC Ltd
  - GTC Ltd
- 4.7 In reaching our decision, we considered all of the stakeholder responses and we have set out our views in the main body of this document. This appendix is our summary of the main issues raised by stakeholders. We consider each stakeholder’s response in turn

### Powercon (UK) Ltd

- 4.8 Powercon is an agent and consultant for a “number of demand, CHP and distributed generation developers” and “have direct experience of working with both WPD and all of the other Distribution Network Operators”. According to its response, Powercon has experience of “DG projects that are between 200kW and 20MW [Solar, Wind, AD and Hydro]”, and “the majority of these involve a high voltage connection”.
- 4.9 The response from Powercon is supportive of WPD’s application. In particular, the response states that “WPD are probably the leading DNO in promoting and supporting competition”.
- 4.10 The response from Powercon made the following specific points:
- On WPD’s efforts to remove barriers to competition, the response states that “WPD is very open about competition and from our experience do not believe that there are any barriers to competition within the (4)WPD areas. Invariably, and on the instructions of our clients, we request both Section 15 and Section 16 quotations and, depending on circumstance, have used both WPD and ICP’s to undertake the connections work.”
  - On the issue of pricing and price transparency, it said that “WPD are probably the most ‘constructive and innovative’ with their non-contestable charges and the initial funding which has been facilitated by providing fair and reasonable connection offers. Clearly there remain issues to be resolved on this front but we welcome the open approach and willingness to engage displayed by WPD.”
  - Powercon are aware of competitive alternatives to WPD, and recognise the steps taken by WPD to promote awareness amongst customers
  - The response adds that “we have found little difference in the processes and approaches that WPD apply to all sizes of DG project.”

### TUSC Ltd

- 4.11 TUSC Ltd is a consultant representing “a number of WPD’s customers”. Its response relates to three DSAs (WPD South West, WPD South Wales and WPD West Midlands).
- 4.12 The response from TUSC made the following specific points:
- On customers’ awareness of competition, it said that WPD “takes every opportunity” to ensure that customers are aware. The response also states that “WPD actively guides customers towards competitors (generally not specifically) where it believes that a competitor may improve on WPD’s timescales. This is extremely useful and is much appreciated by customers”.
  - WPD’s quotations are clear and transparent, and WPD staff provide clarifications where necessary.
  - WPD’s business processes and practices help it to provide “high service quality and makes it very easy for customers to deal with. WPD’s procedures and processes definitely reflect best practice.”
  - WPD’s charges are consistent across all works and POC quotes, and the “two sets of charges are easily comparable”.
- 4.13 The response goes on to say that “WPD’s processes and procedures and indeed culture we feel are such that levels of choice, value and service will endure and continue to improve if the restriction on its ability to earn a margin is removed.”

### GTC Ltd

- 4.14 GTC, through its subsidiaries the Electricity Network Company Ltd and Independent Power Networks Ltd, holds two independent distribution networks operator (IDNO) licenses.
- 4.15 According to the response, GTC does not operate in the DG HV and EHV RMS RMS. However, based on its experience in working with WPD in other RMSs, it believes that “WPD have worked hard to open up the RSM’s within their DSAs and we find that they are one of the companies that have changed the way competition is viewed”.
- 4.16 It also believes that “WPD have removed enough of the barriers to allow competition to thrive and support this application.”

### Confidential

- 4.17 We received one confidential response to our consultation. It is not clear if the comments relate specifically to the DG HV EHV RMS.
- 4.18 The response made the following points about WPD:
- Customers in the WPD East Midlands DSA, and to a lesser extent the WPD West Midlands DSA, have a wide choice of alternative providers. This is not the case in the WPD South West DSA.
  - WPD’s charges for non-contestable works are not consistent between all works quotes and POC quotes for the same connection. According to the respondent, customers seeking a connection from WPD would only be asked to pay a part of

the charges for “upstream network reinforcement” (under apportionment rules), whereas if the same connection is delivered through an ICP, the apportionment would not apply and the customer would have to pay “100% of the upstream reinforcement works”.

- On at least one occasion, WPD has asked a customer to agree to indemnify WPD “in perpetuity” against any liability arising out of assets built or civil works undertaken by an ICP. WPD subsequently withdrew this condition when challenged.
- On design approvals, the respondent states that WPD has changed its requirements after the ICP has built assets, even though these assets were built to a design that had been previously approved by WPD.