



Application by SP Manweb PLC, dated 2 December 2009 for consent under Section 37 of the Electricity Act 1989 to install and keep installed a 132kV overhead electric line connection from the proposed Llandinam Wind Farm to Welshpool Substation (the "Application")

PAPER EXPLAINING THE REGULATORY SCRUTINY TO WHICH SP MANWEB IS SUBJECT

1.1 Summary

1.2 The below paper sets out a summary of the regulatory regime under which SP Manweb operates. At a very high level, it can be summarised as:

1.2.1 Under-design of a connection would be non-compliance with SP Manweb's statutory duties;

1.2.2 Over-design would mean a solution costs too much meaning that a potential customer may go to an independent distribution network operator or any other third party (an independent connection provider) to deliver the solution which would then have to be adopted by SP Manweb (provided that it met certain standards);

1.2.3 In addition, SP Manweb would not be in compliance with its licence conditions if it over-designed a connection. SP Manweb takes compliance with its licence conditions and statutory duties seriously. As such, in addition to the disincentive to over-design noted at paragraph 1.2.2, SP Manweb would face the reputational issues and associated penalties from Ofgem from acting outwith the scope of its charging scheme and not delivering the connection economically or efficiently.

1.3 Ofgem

1.4 Ofgem is the Office of Gas and Electricity Markets. Its website sets out that it is "a non-ministerial government department and an independent National Regulatory Authority, recognised by EU Directives. Our principal duty is to protect the interests of consumers, both present and future. We do this in a variety of ways including:

- promoting value for money
- promoting security of supply and sustainability, for present and future generations of consumers, domestic and industrial users
- the supervision and development of markets and competition
- regulation and the delivery of Government schemes.

We work effectively with, but are independent of, government, the energy industry and other stakeholders within a legal framework determined by the UK government and the European Union

The Authority determines strategy, sets policy priorities and makes decisions on a wide range of regulatory matters, including price controls and enforcement".

1.5 Ofgem role in regulating SP Manweb, including any involvement in auditing designs

1.6 SP Manweb has a distribution licence under the Electricity Act 1989. Under s9, there is a duty to facilitate competition in supply and generation of electricity. In addition, certain of SP Manweb's licence obligations regulate how SP Manweb can charge for the services that it provides.

- 1.7 Condition 13 (Charging Methodologies for Use of System and Connection) is relevant in this context:
- 1.7.1 Paragraph 13.1 requires a licensee to have in place a Connection Charging Methodology (CCM) and to comply with it.
- 1.7.2 Paragraph 13.2 requires licensee to review the CCM every year and make such amendments as are necessary for achieving the Relevant Objectives contained within the Distribution Connection & Use of System Agreement (DCUSA)
- 1.7.3 Paragraph 13.3 contains the detail of the Relevant Objectives, namely:
- (a) compliance with CCM facilitates the discharge of obligations imposed upon us by the Act and the licence
 - (b) compliance with the CCM facilitates competition in generation and supply of electricity and does not restrict, distort or prevent competition in the transmission or distribution of electricity
 - (c) compliance with the CCM results in charges which reflect as far as reasonably practicable (taking account of implementation costs) the costs incurred by the licensee in its distribution business
 - (d) the CCM takes account of developments in the licensee's distribution business
 - (e) requires compliance with the Regulation and any relevant binding decision of the European Commission and/or the Agency for the Co-operation of Energy Regulators.
- 1.7.4 Paragraphs 13.4 to 13.8 details the procedure for making modifications to the CCM.
- 1.7.5 Paragraphs 13.11 to 13.14 details the Ofgem approval process for granting a modification to the CCM.
- 1.7.6 Paragraph 13.15 requires the licensee to publish its CCM and make it publically available. SP Manweb's CCM is found at: http://www.spenergynetworks.co.uk/userfiles/file/SPEN_connection_methodology.pdf
- 1.8 Section 5 of this document contains the Methodology itself and must be developed in accordance with the Minimum Scheme:

"5.1 The Minimum Scheme is the Scheme with the lowest overall capital cost (as estimated by us), solely to provide the Required Capacity. The Minimum Scheme will be subject to:

- o accepted industry standards, including the requirements of the Distribution Code;*
- o the status and configuration of the Relevant Section of Network (RSN);*
- o the standard sizes and types of equipment currently used by us on our Distribution System which shall be reasonable in all the circumstances;*
- o maintaining our ability to minimise regulatory penalties associated with the Interruptions Incentive Scheme and the Guaranteed Standards of Performance; and*
- o where the Customer is an LDNO, maintaining the Customer's ability to minimise regulatory penalties associated with the Guaranteed Standards of Performance*

*and shall be consistent with our statutory and licence obligations including the requirement to develop, maintain and operate an **efficient, co-ordinated and economical electricity Distribution System.**"*

- 1.9 The licensee is obligated to comply with Minimum Scheme requirements (see Paragraph 13.1 of Condition 13 of the licence above).
- 1.10 Costs in excess of the Minimum Scheme are required to be met by the licensee.
- 1.11 In terms of the economic return that SP Manweb can make, paragraphs 6.5 to 6.7 of the CCM contain details of “Margin included in Connection Offers”:
- 1.11.1 Under paragraph 6.5 the licensee is allowed to charge a margin on certain elements of connections work as allowed by Licence. Margins can only be applied to Contestable Work (construction of Extension Assets and other activities as set out in paragraphs 6.15 to 6.23 of the CCM);
- 1.11.2 Under paragraph 6.6, the margin (if any) is either “regulated” (which is set at 4% by Licence) or is “unregulated” which is not set by SP Manweb's licence. SP Manweb's ability to apply these two types of margin is governed by Ofgem.
- 1.12 The Llandinam Scheme will include both Contestable Works (paragraphs 6.15 to 6.23) and Non-Contestable Works (paragraphs 6.11 to 6.12). SP Manweb we can only charge a margin on the Contestable Works. This margin is limited to 4%.
- 1.13 **Competition in Connections**
- 1.14 Competition within the DNO space was introduced by Ofgem in the early 2000s to provide customers with competitive connection alternatives and reduce industry costs.
- 1.15 Ofgem Price Control decision (DPCR5) required each distribution licence holder to submit Competition Notices addressing efforts made to reduce barriers to competition, provide greater transparency of pricing to customers, promote awareness of competitive alternatives, have in place processes and procedures which facilitate competition in connections, to open up non-contestable activities to competition and, with respect to market segments defined by Ofgem, to evidence levels of actual and potential competition in the market place i.e. the customer can opt NOT to select a licensee to carry out the contestable elements where they feel the price is too high.
- 1.16 SP Manweb's Competition Notices can be found at: <https://www.ofgem.gov.uk/ofgem-publications/82703/finalcic16aug2013.pdf>
- 1.17 **Internal process and corporate governance**
- 1.18 Prior to issue, all connection offers made by SP Manweb follow an internal governance process. This includes technical authorisation (the Llandinam Scheme received technical approval at the Systems Review Group) and Authority to Quote (ATQ).
- 1.19 The first stage financial approval within SP Manweb allows an offer to go out to a customer based upon an estimate of cost (indicative offer). The estimated cost in this offer is based upon unit costs derived from recent tender returns from customer driven connections and internal reinforcement projects. This first stage offer is an indicative offer since the actual tender return costs are unknown at this stage. If pre-engineering activities reveal engineering difficulties and possible unexpected costs, the design might have to be rectified. At various stages in the project life cycle the engineering section reviews whether unit costs require updating in order to align with recent tender returns. If a design change or updated unit costs result in a cost increase, a variation (based upon estimated cost) can be issued to inform the customer.
- 1.20 The second stage financial approval follows on from pre-engineering activities, consent approval of a route, and the tender returns. If there is a difference in cost from the previous stage, then a variation can be issued to inform the customer.

- 1.21 The authorisation process provides a mechanism for approving costs that are anticipated to be changed compared to the original approved costs. Furthermore there is also a mechanism to release additional contingency funds that were anticipated and identified at stage three financial approval
- 1.22 All connections offers (regardless of value) require to be signed by two people. One of those people is a member of staff with the financial authority to approve the scheme's issue and the second person acts as a 'control' signatory - effectively providing a second person check that the quotation is competent and is compliant with SP Manweb policies and procedures i.e. Ofgem compliant.
- 1.23 The Llandinam Scheme offer letter will have been signed in person by the Regulation & Commercial Director. The offer requires the Design Engineer to confirm that the project has been developed in accordance with the Minimum Scheme requirements, as explained above.