

Rachel Fletcher
Director, Distribution
Ofgem
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Your ref

Our Ref

Date 1 October 2008

Contact / Extension

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Dear Rachel

**ASSESSMENT AND DESIGN /APPLICATION FEES (“A&D FEES”)
SECTION 16, ELECTRICITY ACT 1989 CONNECTION REQUESTS**

I am writing in response to your open letter of 14 August 2008.

As you may know, following further consideration, SP Energy Networks (“SPEN”) has suspended A&D Fees for connection applications made under section 16 of the Electricity Act 1989 (“S16 Applications”) with effect from 18 September 2008. This action has been taken pending further investigation into the legal position in relation to such fees and the establishment of satisfactory arrangements for recovery of SPEN’s additional costs in providing quotations where fees do not apply (i.e. speculative applications).

We have until now charged A&D Fees in accordance with the charging methodology statements of SP Distribution and SP Manweb as approved by the Authority. Whilst we acknowledge Ofgem’s view that the current practice of levying upfront A&D Fees is not expressly provided for within the Act, SPEN’s position is that the absence of such express provision does not prevent DNOs from engaging in such practice. Furthermore, the practice of levying A&D Fees is stated in terms within the Charging Methodology Statements of SP Manweb plc (“SPM”) and SP Distribution Limited (“SPD”) respectively. As you are aware these statements have been approved by Ofgem. In the absence of a mechanism to recover such charges, SPEN will be forced to find an alternative means of recovering these costs. SPEN strongly believes that the fairest and most cost reflective solution would be for these costs to be paid by those who cause them to be incurred.

In Ofgem’s letter of 14 August, it recognises the issue of how such costs are to be recovered and the related concern over potential increases in volumes of speculative applications in the absence of A&D fees. However, the letter does not put forward any proposals in this area, or provide distributors with assurance regarding recovery of the costs concerned.

We incur significant costs in preparing quotations. In many cases these involve detailed system studies needing to be carried out, and prolonged investigation and preparatory work before a scheme can be designed and costed.

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As you will know we do not at present apply A&D Fees for Point of Connection (“POC”) applications (other than a small administration fee to the successful bidder). We were in the process of preparing a submission to Ofgem to seek approval for changes to our charging statement for fees to be applied at the time when your letter was issued. As you are aware, competition in the SPEN licensed areas is highly developed. For example in 2007/08 almost half of all connections in SPEN’s areas were carried out by ICPs. IDNOs are also firmly established in both areas, and last year 85 embedded IDNO networks were connected in SPD’s area alone.

In 2007/08 the A & D Fees for S16 Applications amounted to some £580,000 for SPD alone, excluding applications for connections involving work at EHV. We do not know how many more applications might have been received had no fees applied. However, based on our experience in the Competition in Connections market, we believe that a multiple of 2 or even 3 times the current level of applications is a credible estimate of the possible impact of suspending A&D Fees for S16 Applications. The inability to continue charging A&D Fees will therefore have a major financial impact on SPD/SPM.

We understand that following industry discussions with BERR the Energy Bill is unlikely to be amended to allow for fees to be charged for S16 Applications. **However, in the absence of such measures, we believe that the most reasonable route is for Ofgem to provide comfort to companies that a logging up mechanism will be considered as part of the DPCR5 process to allow companies to recover costs of abortive quotations to the extent that these were not taken into account in setting the current allowances.** We also think that if no advance fee mechanism can be applied, allowed operating costs should explicitly take into account the costs incurred by companies in dealing with applications for both S16 and POC requests going forward.

Your letter also asks for suggestions on how speculative applications can be managed if the statutory position remains unchanged.

We believe that in the absence of application fees, it would be reasonable for a distributor to decline to consider multiple variants from the same party of requests for quotations for one site at the same time. It is difficult to see how a party asking for, say, 3 separate quotations for differing capacities at the same site “requires” a connection of a given capacity, as provided for in sections 16A (1) and (2) of the Electricity Act 1989. We believe that in such a situation the distributor should be entitled to ask which capacity is required for that connection. If the other party seeks a feasibility study to ascertain the possible costs for different capacity scenarios, we and most other distributors offer such a service, and the basis for such charges is set out in charging statements. The section 16A process should not be used as a means of securing feasibility studies free of charge.

Another option could be to explore the current process set out in s.16A (5) to determine whether distributors could amend the structure and content of their offers/notices to applicants. For example, such an offer could provide a high level budget quote for connection based on a reduced level of assessment and design detail. Following acceptance, a fully detailed assessment and design would be carried out. All associated expenses would be included in the offer together with any additional costs incurred as a result of the more detailed assessments being undertaken post acceptance.

Although this is not a complete answer to the problem of managing speculative applications, we think that a more rigorous approach to multiple applications as outlined above is consistent with the statutory position.

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I look forward to hearing from you in relation to the points raised, including assurance regarding cost recovery for abortive applications.

Please contact me if you would like to discuss.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Scott Mathieson', written in a cursive style.

Scott Mathieson
Regulation & Commercial Director

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