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Dear Roger,

Connections Assessment and Design (A&D) fees levied by Electricity Distribution Network Operators (DNOs)

Scottish and Southern Energy (SSE) has serious concerns with the implications of Ofgem's decision to require DNOs that levy upfront charges as a pre-condition of providing a section 16A(1) connection offer to amend their charging methodologies to remove upfront charging for A&D work.

You will be aware from telephone discussions with my colleague, Ian Bruce, that we continue to work with the other DNOs to consider the arguments for retaining the upfront A&D charges. Discussions with the other DNOs have highlighted differences in interpretation of the requirements of the Act which will require further legal analysis. Our own, initial, position is in agreement with Ofgem's decision that upfront fees for providing a section 16A(1) connection offer is not permitted. We have therefore suspended our section 16A(1) connection application upfront A&D charges with effect from 14th August 2008, i.e. the date of Ofgem's consultation letter.

However, it needs to be recognised that it is entirely typical of applicants to request a section 16A(1) connection to our network long before they are in a position to accept a formal connection offer, just to establish the likely overall costs of a project, or potential project. In some cases applicants will ask us to consider a number of possible scenarios and request that

we provide them with quotations for a range of eventualities. Clearly, in these situations, the applicant has not finalised their requirements and is therefore unlikely to be in a position to genuinely require a formal offer at that stage. The same is also true for the many applicants who request technical assessments for connecting additional load which may, or may not, result in the completion of any works. Like the new connection scenarios, our costs in carrying out these load based assessments will be incurred regardless of whether or not the offer is accepted. These typical speculative approaches often lead to the applicant returning repeatedly for a revised quotation. In the circumstances described above, fees have served to encourage applicants to request a level of response from the DNO which more reasonably corresponds with the status of their project and the likelihood of it progressing to an actual connection. They have also served to allocate the assessment and design costs to the most appropriate party, which in our view is the developer. The removal of fees invites much greater speculative application activity and we believe it is entirely appropriate and reasonable to continue to recover our A&D costs as upfront fees. We suggest that further work needs to be carried out by the DNOs and Ofgem, possibly through the Commercial Operations Group (COG), in order to agree a consistent approach to charging across the industry.

In the meantime, we wish to make it clear that it is our intention to continue to levy upfront charges for carrying out A&D work for feasibility studies and the provision of budget costs where the applicant is not requesting a formal offer of connection, or cannot provide the minimum information required in order for us to provide a formal connection offer. This may be because the applicant has not finalised their capacity requirements, is unable to provide a proposed infrastructure (e.g. road) layout, or they do not act on behalf of the current landowner or land occupier or agent, or cannot identify a firm date for requiring the connection.

We will also continue to pass through charges from National Grid where they need to assess distribution connections that may have an impact on the transmission system. These fees are significant; typically £35k for demand and £3k to £17k for embedded generation, and cannot be avoided by the DNOs. We strongly believe it is reasonable to pass these charges to the applicant.

Furthermore, charges will continue to be levied where the applicant wishes to carry out work at their own expense in order to reduce the uncertainty (and cost) of the formal connection offer. For example, where we have provided the applicant with a quotation which assumes a worst case cost for excavating and reinstating the cable route due to uncertainties regarding the ground conditions, the applicant may wish us to carry out an assessment of the cable route by digging trial holes in order to confirm the suitability of the proposed route and ground conditions, and to reflect this in the quotation. In this type of situation, as the additional works are being carried out with the agreement of, and to the benefit of the applicant, we would expect to recover these costs. It should also be noted that we often receive requests to provide an early estimate of costs to inform developers of the viability or otherwise of a scheme which is at the preliminary stages of feasibility, commercially and physically as well as politically. Until such

time as the current situation with upfront fees is clarified and reassessed, all new applicants requesting connection quotations (section 16A(1) and other A&D requests) who are impacted by our decision to suspend certain upfront fees are being advised of the potential outcomes of the current consultation process.

We fully support Ofgem's view that the practice of upfront A&D charging is reasonable and efficient by directly charging parties who impose costs on the DNOs. Recovering these costs by charging upfront fees protects consumers generally from bearing the significant costs, both individually and cumulatively, associated with preparing formal offers of connection to our network. It is our understanding that the gas distribution and transmission network operators and the electricity transmission network operators have not been directed by Ofgem to stop charging upfront A&D fees. This appears to confirm our view that the reason for requiring DNOs to remove upfront A&D charges from their charging methodologies is due simply to shortcomings in the drafting of the Act. Allowing the exploitation of a potential unintended 'loophole' in the Act by certain parties in order to avoid paying for services they receive will not be welcomed by consumers. It is therefore unfortunate that, in the absence of being in a position to charge upfront A&D fees to the parties making a section 16A(1) connection application, the alternative arrangements are likely to include recovery of attributable costs from all consumers through the price control mechanism. Therefore, in the event that it is not possible to reclaim all A&D costs from applicants, we believe it will be necessary for Ofgem to review the DPCR4 settlement and agree the process by which DNOs will proceed with claims to recover their full costs associated with providing formal connection offers which are not accepted. This process will also need to take account of previous applicants who paid upfront A&D fees where they subsequently did not accept the formal offer and who are now reclaiming the fees.

We have already started to receive increased levels of speculative connection requests from developers who had previously declined to proceed with an application on the basis of having to pay upfront A&D fees. For example, in SHEPD area, there has been a 3 fold increase in applications from generation developers since the current consultation was published. We know from discussions and correspondence that this is directly linked to the removal of A&D fees, rather than any sudden upturn in the level of serious applicants. In the event that this initial trend continues, we believe there will be a serious impact on our ability to provide timely connection quotations relating to large property developments, industrial and commercial schemes, generators and sites being connected by Independent Connection Providers (ICP) and Independent Distribution Network Operators (IDNO).

In order to understand the potential impact on our workload we carried out an internal survey of recent connection requests to identify the effect upfront fees had on these applications. The outcome of the survey revealed that:

- approximately 40% of applications did not proceed when requested to pay upfront A&D fees; and
- of those that did proceed to a formal offer, only around 50% accepted the offer during the validity period

These results clearly show how the behaviour of the parties requesting connection offers is affected by the requirement to pay our cost-reflective and transparent upfront charges associated with providing formal connection offers. The fact that 70% of these initial applications did not proceed to the acceptance of a formal connection offer highlights the level of wasted effort on our part. We therefore believe that, when combining these survey results with the early indication of developers seeking formal connection offers where previously these had been declined due to their reluctance to pay A&D fees, we will see a very significant increase in the number of applications for speculative developments. These will involve significant cost and time to respond to.

In summary, we believe that Ofgem's instruction to amend our connections charging methodology to remove charges for upfront A&D work for section 16A(1) connection applications will have a detrimental impact on our ability to provide timely connection offers due to having to deal with an increase in speculative application requests. It will remove the protection against abuse of our licence obligation to provide an offer of connection to our networks on request and lead to increased inefficiency and costs. We will continue to charge upfront fees for providing certain A&D work as outlined above and will work with DNOs to agree a consistent approach. Where it is not possible to recover all our costs, we will seek to agree how these costs as well as the potential repayment of specific categories of fees will be recovered through the price control mechanism.

If you have any queries on the above or wish to discuss any of the issues raised then please do not hesitate to contact me.

Yours sincerely,

Malcolm J Burns
Regulation Manager