



Electricity Distribution Network Operators, Independent Distribution Network Operators, Independent Connection Providers and other interested parties

Promoting choice and value for all customers

Our Ref: A&D fees_14_08_08-123/08
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Dear Colleague

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

Background

A number of DNOs levy upfront A&D fees when managing certain connections requests. Typically, these charges relate to assessing the impact of potential connections on the network and the design work required for such connections. The fees that are levied and the types of schemes that will attract such charges are set out in the relevant DNOs' connection charging methodology statements.

This procedure of levying upfront A&D charges as a pre-condition of providing a connection notice (in accordance with section 16A(5) of the Electricity Act ("the Act")) has been questioned by a new entrant distribution network company. We have considered the arguments put forward and the applicable statutory framework (section 16 to section 21 of the Act).

In summary our view (which is discussed in detail in this letter) is as follows:

- the practice of upfront charging for A&D works as a pre-condition of providing a section 16A(5) connection offer is not consistent with the Act;
- the A&D fees can only be recovered if the full and formal connection offer, the section 16A(5) notice, is accepted by the customer; and
- A&D fees fall within section 19(1) of the Act as they are expenses incurred in respect of making the connection (i.e. where any electric line or plant is provided as long as they are reasonably incurred as required by that section).

As a consequence DNOs that currently levy upfront A&D charges as a pre-condition of providing a connection offer will be required to amend their charging methodologies to remove upfront charging for A&D work.

Purpose of this letter

Ofgem has decided to consult on the general issues that arise as a result of this matter. In this letter we:

- set out the background to A&D fees;
- set out Ofgem's view;
- discuss the issues and implications arising i.e. that DNOs review and update their methodologies to ensure that charging arrangements comply with the statutory framework;
- invite DNOs to submit their views on any other implications for their businesses; and
- set out the next steps.

Application of A&D fees

Typically, A&D work is charged upfront for connection requests relating to large property developments, non-domestic customers, generators and a number of connections schemes progressed by Independent Connection Providers and Independent Distribution Network Operators.

Connection requests can be of a speculative nature, especially those that relate to new build housing and large retail developments.

Overview of the issue

It has been queried whether the relevant statutory provisions actually permit DNOs to require the *upfront* payment of an A&D fee as a pre-condition of making a formal connection offer. It has been argued that there is no express provision in the Act for DNOs to make payment of A&D fees a condition of providing a connection offer in accordance with section 16A(5) of the Act and there is no basis for DNOs to recover the cost of making a connection offer if the connection request does not go ahead.

Ofgem's views

We have considered the above arguments. Our views are set out below.

Overview of the statutory scheme

The statutory scheme provided by sections 16 to 21 of the Act places a statutory duty on DNOs to connect any premises or distribution system of another authorised distributor to their distribution system under section 16(1) of the Act. The request may be made by the owner or occupier of premises or an authorised supplier acting with the consent of the owner or occupier of the premises or an authorised distributor. The request is made by way of notice given under section 16A(1) of the Act. As soon as practicable after receiving the notice, and any information requested (section 16A (3)), a DNO is required to make a formal connection offer, given by way of notice under section 16A(5) of the Act.

The notice must contain, amongst other things, details of the payment required under section 19(1) of the Act which allows the recovery of expenditure reasonably incurred in providing the connection (by way of an electrical line or plant) and any other terms (which are reasonable under the circumstances) which the applicant will be required to accept under section 21 of the Act.

Recovery of A&D fees

We believe it is not permissible for distribution licensees to recover their A&D costs from any connection applicants under section 16/16A of the Act unless and until a distributor has given a formal offer notice required by section 16A(5) stating the particular terms as to connection, such notice is accepted by the applicant and the DNO provides the connection. Also, there is nothing in section 16, nor in the procedure provided for in section 16A, that permits a DNO to impose any charges as a pre-condition to its meeting the duty under section 16A(5) to give a formal offer notice setting out its full terms to connect. All stages leading up to that point (as provided for by section 16(1)-(4)) deal with the provision of information necessary for a distributor to issue a formal offer notice. The giving of that

offer notice is the first stage at which any terms/payments are open to acceptance or non-acceptance by an applicant. If the applicant does not accept those terms in the offer notice, there is no basis for any charge.

A&D charges can be recovered within section 19(1) of the Act as they are expenses incurred in respect of making the connection (i.e. where an electric line or plant is provided) as long as they are reasonably incurred (as required by that section).

Introducing the recovery of upfront A&D fees into the DNO licence

A&D fees cannot be recovered either by the introduction of new licence conditions or amending existing conditions in respect of speculative connection applications where those offers for connection are not accepted since any modification to the licence conditions of a distributor's licence have to comply with the statutory regime set out under sections 16 to 21 of the Act, which, in our view, does not provide for recovery of A&D fees in this circumstance.

Reasonableness of charging upfront A&D fees

The practice of upfront charging has been a feature of how the market operates for sometime. We consider this practice to be reasonable and efficient by directly charging parties who impose costs on the DNO.

Recovering these costs protects consumers generally from bearing the costs of speculative connection requests and provides some protection against abuse of the obligation on DNOs to provide an offer of connection to their networks on request (this obligation does not distinguish between contestable and non-contestable elements of connection).

We discussed with the Department for Business Enterprise and Regulatory Reform the possibility of an amendment to the Energy Bill to allow upfront charging for A&D charging in certain circumstances, however, this was not feasible. Therefore, going forward, we will seek to make an amendment to the Act to allow upfront charging for A&D fees in certain circumstances when a suitable legislative vehicle becomes available. This is likely to involve further consultation. We will seek to ensure that any amendment to the Act and the consequential changes that occur facilitates upfront charging in certain circumstances that are not detrimental to an emerging competitive market.

Implications – views invited

Amendments to methodologies

We are concerned that some DNOs' methodologies are not compliant with the statutory arrangements. Therefore, it is imperative that DNOs review their methodologies and raise the necessary changes in the form of modifications which we will consider in line with the relevant licence arrangements. To ensure that we are able to review and assess the modifications in the most efficient manner, we recommend that DNOs co-ordinate and submit their modifications jointly in a timely fashion.

We recognise that DNOs may be concerned that they are unable to recover A&D fees that they were previously recovering and that the cost of progressing speculative connections requests may increase, we welcome your views on the way forward. In addition there may be other issues that this letter raises and we would welcome your views on these.

Next Steps

Responses should be sent to connections@ofgem.gov.uk by 2 October 2008. If you wish to discuss any of the matters arising in this letter please do not hesitate to contact me on 020 7901 7346.

Yours sincerely

A handwritten signature in black ink, appearing to be 'R.M.', with a large, sweeping flourish extending to the right.

Roger Morgan
Senior Manager, Compliance