

# The Electricity (Connection Offer Expenses) Regulations 2018

Department for Business, Energy & Industrial Strategy

RPC rating: **fit for purpose**

## Description of proposal

At present, distribution network operators (DNOs) can charge a fee (called an assessment & design, or A&D, fee) only to customers who accept a connection offer to the electricity distribution network, to cover the costs incurred by the DNO in preparing the offer. DNOs are currently not allowed to recover costs from those who apply for a connection but do not accept an offer. The connection to the network can be to either receive or supply electricity. All customers are businesses; individuals do not need to apply for a connection.

The number of connection offers not accepted has grown significantly since 2010/11. DNOs are especially concerned that applications are being made in bulk, with few of these being accepted. The applications appear to be primarily to obtain information from the DNOs rather than necessarily in pursuit of a connection. There is also concern about equity; that other customers are facing higher fees as a result.

The proposal is to introduce secondary legislation to allow DNOs to charge A&D fees up front, so that they can recover costs incurred in preparing an offer from both those who accept and those who do not accept an offer.

## Impacts of proposal

The proposal will affect all six DNOs, business customers applying for a connection offer and *Ofgem*.

### Costs

It is expected that all DNOs would decide to make use of the proposal. This is estimated to cost them around £2.8 million over ten years, as a result of one-off IT system changes and ongoing additional invoicing and payment processing. There will also be one-off review and licence change costs to *Ofgem*, estimated at £36,000. As *Ofgem* is an industry-funded regulator, this cost is treated as a direct cost to business. There will also be costs to customers that apply for a connection offer but do not accept one, as a result of having to pay an A&D fee to the DNO.

## Benefits

Under the proposal, DNOs would receive an A&D fee from customers applying for a connection offer but not accepting it. This benefit to DNOs exactly matches the cost to customers having to pay the fee, which is discussed above.

Based upon the average cost of preparing connection offers and the number of applications, the Department estimates a total current cost of preparing connection offers of £779 million over ten years in present value terms. Using evidence from DNOs, the Department assumes that the proposal would result in up to 40 per cent of connection applications no longer being made, with a central estimate of 20 per cent, equivalent to a saving of £156 million. This is treated as an (indirect) efficiency/resource saving for DNOs.

The Department expects that customers accepting connection offers will benefit as they would no longer effectively cross-subsidise those who do not accept offers and as DNOs pass through efficiency savings to them.

The overall net present value (NPV) of £153 million consists of the (£156 million) resource saving referred to above minus the (just under) £3 million cost to DNOs and *Ofgem*. All of the other impacts are transfers between DNOs and customers, or among customers, and therefore, offset each other. The Department estimates a business NPV of -£2.41 million and an equivalent annual net direct cost to business (EANDCB) of £0.2 million. The business NPV consists of the costs to DNOs and *Ofgem* (recovered from business) referred to above.

## **Quality of submission**

### Business impact target assessment

The correct assessment of the impacts of the proposal for business impact target purposes is not straightforward. The Department excludes the resource saving to DNOs on the basis that it is indirect because it requires “...*behaviour change and therefore a further instance of decision making...*” (paragraph 46) and DNO’s resources being “*better deployed*” (table 4, page 12). The behaviour change referred to is potential “customers” being deterred from applying as a result of the up-front

fees. The Department's approach here is consistent with the agreed treatment in other cases.<sup>1</sup>

The EANDCB consists almost entirely of costs to DNOs that are incurred if they wish to make use of the proposal. There is an argument that this impact should not be scored as a cost of regulation on the basis that incurring these costs is a choice by DNOs and DNOs would only make use of the proposal if it were net beneficial to them. However, since DNOs are currently prevented in law from charging up-front fees, it would seem that the revenue from the fee should be viewed as having a direct benefit to DNOs, and it would be appropriate for the associated costs to DNOs to be netted off from this. Against this, the additional fee income would be fully offset by the corresponding cost to potential customers (all businesses). Given that IT and processing costs have gone up, there is a net cost to business overall. The proposal is, nevertheless, net beneficial to DNOs, and even more so if the indirect resource saving is taken into account. Overall, the Department's approach to classifying impacts for business impact target purposes is reasonable.

#### Wider impacts (including on small businesses)

The IA addresses the risk that customers who would have accepted a connection offer might be deterred from applying by up-front fees. Some of these customers could be smaller developers, e.g. community renewable projects. The Department explains that feedback from stakeholders suggests that this is likely to be a very small risk as these projects tend not to submit speculative connection applications, and the level of A&D fees would be relatively small. The IA also notes that such projects accepting their connection offers are likely to pay lower A&D fees. Nevertheless, the IA would benefit from providing additional information on the size distribution of business customers and further discussion of the potential for applications being deterred and the impact this could have.

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<sup>1</sup> For example, MoJ's approach on whiplash where savings to business from claimants choosing to no longer claim were deemed indirect.

### Departmental assessment

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| Classification   | To be determined |
| Equivalent annual net direct cost to business (EANDCB) | £0.2 million     |
| Business net present value                             | -£2.41 million   |
| Societal net present value                             | £153 million     |

### RPC assessment

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|-------------------------------------|--|
| Classification                      | To be determined once the framework rules for the current parliament are set |
| Small and micro business assessment | Sufficient   |



**Anthony Browne**, Chairman