

Company Secretary
Scottish and Southern Electricity Networks

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By email Emma Clark

Email: duos@ofgem.gov.uk

Date: 6 February 2025

Dear Company Secretary,

Direction issued to Scottish Hydro Electric Power Distribution plc (SHEPD) and Southern Electric Power Distribution plc (SEPD) to derogate from the Distribution Use of System (DUoS) Extra High Voltage Distribution Charging Methodology (EDCM), issued under Standard Licence Condition (SLC) 13B Part E of the Electricity Distribution Licence and the Common Distribution Charging Methodology (CDCM) issued under the SLC 13A Part E of the Electricity Distribution Licence ¹

This letter contains a Direction to Scottish and Southern Electricity Network's (SSEN) Electricity Distribution Licence areas SHEPD and SEPD (the licensees) to derogate from the EDCM and CDCM for 2026/27 charges, so that it can produce a full set of DUoS charges with no fixed credits. The direction allows SSEN to amend the charging methodology for the licensees. The Direction allows SSEN to amend the EDCM by carrying over locational components and network use factors from previous years. Additionally, for SHEPD only, it allows SSEN to reapportion negative fixed charges for final demand consumers within a residual band to the capacity charge for the same group of consumers. For the CDCM, the Direction allows SSEN to reduce the value of the Distribution Reinforcement Model (DRM)

¹ Read [SLC 13 of the Electricity Distribution Licence](#)

such that the forward-looking charges of the CDCM recover a particular value (i.e. to a point where the residual surplus is at a level that allows production of a complete set of tariffs).

We consider it is in the interests of its customers overall to produce a complete set of charges for all customers with no fixed credits. The Direction is attached as an Annex to this letter.

Background

Distribution network operators (DNOs) recover their allowed revenue from customers through DUoS charges. The methodologies for calculating these charges are the extra high voltage EHV Distribution Charging Methodology (EDCM) for the large, industrial customers connected at the highest voltages, and the Common Distribution Charging Methodology (CDCM) for the remaining customers. The CDCM and EDCM are detailed in the Distribution Connections and Use of Systems Agreement (DCUSA) document.

In the 2023 charge-setting period, we were made aware of circumstances in which following the EDCM would result in a negative value 'surplus residual'.² In some cases, this would result in a fixed daily credit being paid to certain sites. We do not consider that a fixed daily credit for Final Demand Sites is cost-reflective nor conducive to competition in the generation and supply of electricity.

We are similarly aware of limitations with how the CDCM seeks to manage a surplus residual. A process exists to reduce some of the forward-looking charges (discounting fixed charges and unit rates) to bring revenue recovery down to the target value. However, an especially large surplus residual may result in the CDCM exhausting the ability to apply discounting and failing to produce a complete set of charges for some network users. We do not consider that compliance with the charging methodology should result in the failure to produce a set of final tariffs.

From the point of the issues within the charging methodologies becoming known to us, we have sought to identify a robust and practical solution.

In response to a surplus residual arising in the EDCM of two DNOs in the 2023 charge-setting period, for 2025/26 charges, we granted a direction to derogate to the affected

² Surplus residual is also understood as a 'negative residual'. This guidance document uses the term "surplus residual" for consistency with the DCUSA.

DNOs to charge outside of the EDCM.³ We described these issues in greater detail in two explanatory notes⁴ published alongside our presentation to the March 2024 Charging Futures Forum.

In July 2024, we published a Call for Input⁵ to the sector, which detailed and sought feedback on our assessment of proposed approaches to manage the effects of surplus residual charges in both the EDCM and CDCM. We subsequently published our guidance for managing the effects of surplus residual charges⁶ in November 2024, which outlined the process by which DNOs should submit requests for direction to derogate from the DCUSA 15-month notice period and relevant charging methodologies.

In December 2024, we directed three DNOs to derogate from the 15-month DUoS charge setting notice period⁷. This allowed them time to confirm an excessive residual surplus, apply intervention options, conduct an impact assessment, and submit a derogation request from the charging methodology to Ofgem, if required.

SSEN's issue and requested direction to derogate

Following our published guidance on managing the effects of surplus residual charges in DUoS charging methodologies, SSEN has finalised its proposed 2026/27 charging figures for the licensees and has confirmed the occurrence of excessive surplus residual charges in its tariffs as a result of applying the EDCM and CDCM to its licence areas.

In keeping with our guidance and in responses to the occurrence of an excessive surplus residual arising within the CDCM and EDCM, SSEN wrote to us on 24 January 2025 to request a direction to derogate from its charging methodology.

For the EDCM, for the licensees, SSEN has proposed to amend the EDCM by carrying over locational components and network use factors from previous years. Additionally, for SHEPD only, it has proposed reapportioning the remaining negative fixed charges for final demand consumers within a residual band to the capacity charge for the same group of consumers.

For the CDCM, SSEN has proposed to evenly reduce the value of each network level of the DRM, to the minimum extent required such that the existing surplus residual allocation

³ Read directions to derogate under SLC 13B Part E of the Electricity Distribution Licence relating to the EDCM for [National Grid Electricity Distribution](#) and [Scottish and Southern Electricity Networks](#)

⁴ Read the [explanatory note on the issue relating to the EDCM](#) and [the explanatory note on the issue relating to the CDCM](#) on the NESO website

⁵ Read the [Call for Input on managing the effects of surplus residual charges](#)

⁶ Read [our guidance for managing the effects of surplus residual charges](#)

⁷ View [the requests to derogate from the DCUSA 15-month notice period and Ofgem decisions](#).

methodology can function. This would be achieved by SSEN applying a scaler multiplier of 99% to the gross asset values of the DRM for SEPD and 82% for SHEPD to produce final DUoS charges.

Our assessment

We have considered SSEN's proposal for the licensees to derogate from the EDCM and CDCM for the licensees, against the process set out in our guidance for managing the effects of surplus residual charges, which has been developed in accordance with the DCUSA charging objectives⁸, our principal objective and wider statutory duties.

DNO Obligations

Without intervention, DUoS tariffs would not be produced for Final Demand customers under the HV Site Specific banded tariffs. In the first iteration of charge-setting, in the SEPD region, High Voltage Band 3 and Band 4 users (c. 550 Meter Points) would not be billable, and in the SHEPD region High Voltage Band 2, Band 3, and Band 4 users (c. 200 Meter Points) would not be billable. This would result in a complex failure of the model that could cause a variety of adverse effects for all Final Demand users. By not being able to charge users of the network in accordance with the charging methodology, the licensees may significantly under-recover revenue, which could prevent or disrupt its ability to safely and efficiently discharge its obligations regarding network operation, improvement, and maintenance.

In contrast, allowing the intervention would better facilitate its ability to recover a correct amount of revenue and allow billing of all customers.

Competition

For the EDCM, negative fixed charges for demand could lead to distortive incentives for customers to hold or increase agreed capacity where it is not needed, which will not lead to efficient system use and could be harmful for competition if it prevents the efficient allocation of capacity to other users. By addressing this issue, the intervention better facilitates this objective. Given the principal cause of the issue and its scale, SSEN has chosen the appropriate approach to addressing negative fixed charges.

For the CDCM, without intervention, the licensees would not be able to bill suppliers in line with its charging methodology. This would result in adverse effects for suppliers with high-voltage customers, whereas an equivalent supplier who did not have such customers in

⁸ The [DCUSA Charging Objectives are in clause 3.2 of DCUSA](#) and are set out in [Condition 22A of the Distribution Licences](#).

their portfolio would not be impacted. This would create a distortion to competition where the supply of electricity to high-voltage customers would carry undue administrative and operational risks for some suppliers to network users, compared to others.

As described in our guidance document (Specific guidance for addressing the CDCM issue, Section 2.22-25), the minimal approach to intervention would result in user tariffs closest to the expected outcome of the charging methodology's management approach in cases of high (but not excessive) residual surplus as detailed in DCUSA Schedule 16 Paragraph 94. The charges levied on network users would be minimally affected compared to the originally-produced charges (excluding those subject to the 0p/kWh floor error), meaning that the relative positions of non-Final and Final Demand users are largely unaffected, as are the positions of differently-banded Final Demand users. While the intervention sought by the licensees would increase the costs faced by non-final demand users and reduce the value of credits awarded to embedded generation, this would be proportionate and limited only to the extent required for the methodology to function.

We consider a uniform change to the DRM to be a balanced approach that does not discriminate between users connected at different voltage levels. Furthermore, as the licensees would be able to charge all relevant suppliers using standard processes, the undue administrative and operational risks associated with supplying high-voltage users as in a case of non-intervention would be mitigated.

Cost-reflectivity

For the EDCM, the intervention relies on some historical data, which reduces cost reflectivity of the model inputs. However, it does remove negative fixed charges, which we have stated are not cost reflective. While not performing strongly against this objective, the intervention is the most appropriate option given the scale of the EDCM negative residual.

For the CDCM, an inability to charge high-voltage users of the network due to the failure of the methodology to produce final tariffs would suggest that affected users have no bearing on the long-run incremental costs of the network. We do not consider such an outcome to be cost-reflective.

The charges that would be produced for high-voltage users of the network using this intervention would significantly reduce the strength of signals related to additional marginal cost of usage at different times of the day. We consider that the effects on user behaviour would be limited in-year and that the decrease in cost-reflectivity for these users would not be adversely affected on an enduring basis. A greater extent of intervention would result in a strengthening of the time-of-use signals, but this would not necessarily be a more cost-

reflective outcome as it could over-emphasise the relative importance of time-of-use signals for all users.

DNO business development

For the EDCM, the status quo would result in charges on the basis of models that were not designed for inputs that result in negative fixed charges. The intervention relies on some historical inputs which do not reflect licensees DNO business development. However, it is the most appropriate intervention in the circumstances.

For the CDCM, as stated in our previous publications on this matter, we believe that the charging methodology should be robust to different network revenue expectations. Where following the charging methodology results in a failure to produce a complete set of tariffs, we consider this issue to be a failure of the methodology to adapt to reasonable year-on-year variation in licensees expenditure.

We note that modification to the gross asset values of the DRM does not follow the expectation that this input accurately reflects in-year costs of procuring additional network build as described in DCUSA Schedule 16 Paragraph 25. However, we consider that the benefits of effectively recovering expected revenue outweigh the disadvantages of not fully reflecting supply chain costs within the calculation of network charges. Intervention in order to secure the revenue requirements of the network better facilitates the licensees DNO business development objective.

Efficiency

As described in our rationale for derogation against the DCUSA charging notice period⁹, we consider that the changes to DNO (licensees) and supplier processes are an additional administrative step required for a suitable assessment of the circumstances by the licensees, the proposal of a path to resolution of the issue, and our assessment of that proposal. We consider that this process has been followed effectively, mitigating the aforementioned risk to the normal operation of licensees and supplier business operations.

Primary Objective & Statutory Duties

We have assessed the proposed intervention in line with our Principal Objective and statutory duties. For the EDCM, the status quo is not in the interests of current and future consumers as it could allow a potential windfall gain for some customers at the expense of others. For the CDCM, we consider that the intervention would better protect the interest of

⁹ Read [Ofgem direction to SSEN to derogate from the DCUSA notice period](#)

consumers compared to the baseline of invalid DUoS charges for some users under the circumstances experienced by the licensees. In having regard to the need to secure that licensees can finance their licensed activities and to promote the efficiency and economy of licensees, we consider that a de minimis intervention to address these issues and allow the correct recovery of revenue through DUoS charges is an appropriate measure.

We also believe that this intervention promotes competition in a way that protects consumers' interests. It does so by mitigating against potential distortions to competition related to:

- negative fixed charges for EDCM customers distorting incentives to hold or increase capacity, and
- between suppliers with high-voltage customers and those without.

We recognise that the intervention changes tariffs for more than just the directly affected network users, but consider that such consequences are proportionate and reasonable in light of the potential disruption to the normal functioning of the DNO (licensees), suppliers, and network users.

Decision

For reasons set out above we have decided to grant SSEN's license areas SHEPD and SEPD a direction to derogate from both the EDCM and CDCM for the 2026/27 charging year. The Direction issued under SLC 13B Part E and 13A Part E of the Electricity Distribution Licence is attached as an Annex to this letter.

The Direction allows SSEN's licence areas to amend the EDCM by carrying over locational components and network use factors from previous years. Additionally, for SHEPD only, it allows SSEN to reapportion negative fixed charges for final demand consumers within a residual band to the capacity charge for the same group of consumers.

For the CDCM, the Direction allows SSEN's license areas SHEPD and SEPD to reduce the value of DRM such that the forward-looking charges of the CDCM recover a particular value (i.e. to a point where the residual surplus is at a level that allows production of a complete set of tariffs) (Annex B).

Any new EDCM or CDCM connections between the publication of charges and the 2026/27 charging year should also have their charges set on an equivalent basis. For the avoidance of doubt, and save as set out in this Direction, in all other respects the charges should be calculated in accordance with the EDCM and CDCM.

This letter constitutes notice under 49A of the Electricity Act 1989.

If you have any queries or comments in relation to the issues raised in this letter, please contact us by email at duos@ofgem.gov.uk

Yours faithfully,

Andrew Malley

Head of Distribution and Residual Charging

Signed on behalf of the Authority and authorised for that purpose

Annex

Direction issued to Scottish Hydro Electric Power Distribution plc (SHEPD) and Southern Electric Power Distribution plc (SEPD) to derogate from the DUoS EDCM issued under SLC 13B Part E of the Electricity Distribution Licence and the CDCM issued under SLC 13A Part E of the Electricity Distribution Licence

1. SHEPD and SEPD to whom this Direction is addressed (the "Licensees") holds a licence granted, or treated as granted, pursuant to section 6(1)(c) of the Electricity Act 1989 (the "Distribution Licence").
2. SLC 13B Part E of the Distribution Licence states the Authority may (after consulting the licensee and, where appropriate, any other Authorised Electricity Operator likely to be materially affected) give a direction ('a derogation') to the licensee that relieves it of its obligations under Part A of this condition in respect of such elements of the EDCM, to such extent, for such period of time, and subject to such conditions as may be specified in the direction.
3. SLC 13A Part E of the Distribution Licence states the Authority may (after consulting the licensee and, where appropriate, any other Authorised Electricity Operator likely to be materially affected) give a direction ('a derogation') to the licensee that relieves it of its obligations under Part A of this condition in respect of such elements of the CDCM, to such extent, for such period of time, and subject to such conditions as may be specified in the direction.

Now therefore:

Pursuant to SLC 13B Part E of the Distribution Licence, for 2026/27 charges the Licensee may may carry over locational components and network use factors from previous years for the EDCM for both SEPD and SHEPD. Additionally, for SHEPD only, SSEN may reapportion the remaining negative fixed charges for final demand consumers within a residual band to the capacity charge for the same group of consumers in the EDCM for 2026/27 charges.

Pursuant to SLC 13A Part E of the Distribution Licence, for 2026/27 charges SSEN may reduce the value of DRM by applying a scaler multiplier of 99% for SEPD and 82% for SHEPD to result in the forward-looking charges of the CDCM recovering a value where the residual surplus is at a level that allows production of a complete set of tariffs.

This Direction shall have effect from the date stated below.

Dated 6 February 2025

Andrew Malley

Head of Distribution and Residual Charging

Signed on behalf of the Authority and authorised for that purpose