



The Company Secretary
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*Bringing choice and value
to customers*

Your Ref: COM-05-006
Our Ref: RBA/DPC/SOC/
Direct Dial: 020 7901 7276

cc: Tony McEntee (by email only)

5 December 2005

Dear Colleague,

**Decision in relation to Modification Proposal to the Use of System Charging Methodology:
Metering Charges to IDNOs**

On 8 November 2005, ScottishPower plc submitted a proposal, reference COM-05-006, on behalf of SP Distribution Limited ("SPD") to the Gas and Electricity Markets Authority (the "Authority")¹ to modify SPD's use of system (UoS) charging methodology statement.

The proposal modifies the UoS charging methodology statement to clarify the approach used by SPD for the charging of metering services in respect of the boundary between SPD's network and that of a connected Independent Distribution Network Operator ("IDNO").

Having carefully considered the issues raised in the proposal, the Authority has decided to veto the proposed modification.

This letter sets out the background to the modification proposal, explains briefly the proposed changes, and sets out the reasons for the Authority's decision.

Background

SPD has licence obligations² to have in place as of 1 April 2005 three charging statements: the UoS charging methodology statement, the statement of UoS charges and the connection charging methodology statement. The UoS charging methodology statement outlines the method by which distribution UoS charges are calculated. SPD has a requirement to keep the

¹ Ofgem is the office of the Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.

² Standard Licence Conditions 4-4B

methodology under review and bring forward proposals to modify the methodology that it considers better achieves the relevant objectives³.

DNO / IDNO Commercial Arrangements

Ofgem has consulted on the issue of boundary metering over the course of the last 18 months⁴, recognising the benefits derived from metering through increased transparency in the calculation of UoS charges and losses but noting that these advantages needed to be weighed against the cost to the end consumers of requiring a meter and the impact on competition due to the costs. In its most recent document, published in July 2005, Ofgem considered that boundary metering was an important issue and stated that it was necessary to identify a suitable mechanism that ensures electrical flows across the boundary can be measured or estimated accurately.

Ofgem considered that the industry, working together, needed to identify suitable and proportionate mechanisms to achieve this aim and recognised that different arrangements may be proportionate for different connection scenarios to ensure that connections are least cost. A workshop discussing this matter further was held on 28 September 2005⁵.

SPD Modification Proposal

SPD proposes to clarify its UoS methodology statement by expanding the section dealing with charges for meter provision. SPD states that this change clarifies its approach to the charging of metering services in respect of boundary metering. The modification proposal reports submitted by SPD can be found on the Ofgem website as an attachment to this document.

The proposed new wording:

- specifies the type of meter that must be installed at the boundary between SPD's network and that of a connecting IDNO, and states that the charge for this will be borne by the IDNO;

³ The relevant objectives for the use of system charging methodology, as contained in paragraph 3 of standard licence condition 4 of SPD's distribution licence are:

- (a) that compliance with the use of system charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by this licence;
- (b) that compliance with the use of system charging methodology facilitates competition in generation and supply of electricity, and does not restrict, distort, or prevent competition in the transmission or distribution of electricity;
- (c) that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its distribution business; and
- (d) that, so far as is consistent with sub-paragraphs (a), (b), and (c), the use of system charging methodology, as far as reasonably practicable, properly takes account of developments in the licensee's distribution business.

⁴ Ofgem has published the following documents, all of which are available on its website: 18/04 - Regulation of Independent Electricity Distribution Network Operators - consultation paper (29/07/2004); 18/05 - Regulation of Independent Electricity Distribution Network Operators - Initial Proposals Document (31/01/2005); 176/05 - Regulation of Independent Electricity Distribution Network Operators (26/07/2005).

⁵ A note of this workshop, 'Note of 28/09/2005 workshop on issues at the boundary between Distribution Network Operators and Independent Distribution Network Operators', can be found in the 'IDNO Regulation' section of the Ofgem website.

- states that SPD will provide or procure provision of meter operation and related services to meet SPD's requirements for UoS billing purposes, and will charge the IDNO for these services; and
- states that UoS charges exclude the costs of meter provision and operation, which will be charged separately as detailed in the IDNO's Connection and Use of System Agreement.

SPD believes that this change better achieves the relevant objectives by:

- facilitating greater accuracy in measuring the use of SPD's system by another licensed distributor, so helping to ensure that charges reflect SPD's costs; and
- taking account of the significant growth in the number of independent networks connected, or proposed to be connected, to SPD's distribution network.

The Authority's decision

This proposal reflects a change to SPD's UoS charging methodology, by introducing requirements in relation to IDNOs that were not previously specified in this methodology. The change to the UoS charging methodology requires approval from the Authority in line with SLC4.

The Authority has considered the proposal against the relevant objectives and wider statutory duties. We consider that the change to the UoS charging methodology does not better achieve the relevant objectives. The relevant objectives considered are set out below along with Ofgem's view on the proposed modification in relation to each objective.

That compliance with the use of system charging methodology facilitates competition in generation and supply of electricity, and does not restrict, distort, or prevent competition in the transmission or distribution of electricity

The proposed modification stipulates specific technical requirements for metering at the boundary between SPD and connecting IDNOs. The use of SPD's system by an IDNO may be measured using a variety of methods, and the most appropriate solution will not be the same in all cases, for example due to the size of the connecting IDNO network. Ofgem considers that SPD and the connecting IDNO should work together to find the most appropriate solution in each situation. The requirements specified by this proposed modification may therefore, in some cases, impose requirements on IDNOs that are higher than necessary. This is at variance with the objective that compliance with SPD's UoS charging methodology does not restrict, distort, or prevent competition in the distribution of electricity.

That compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its distribution business

As stated, the use of SPD's system at the boundary with IDNOs may be measured by a number of methods. The most appropriate means of measuring the UoS to an appropriate degree of accuracy will not be the same in all cases. The proposed modification is not therefore necessary in order to achieve the relevant objective that SPD's charges should reflect the costs incurred in its distribution business.

That, so far as is consistent with sub-paragraphs (a), (b), and (c), the use of system charging methodology, as far as reasonably practicable, properly takes account of developments in the licensee's distribution business.

Due to the availability of alternative solutions for measuring an IDNO's use of SPD's system, this amendment does not assist SPD in ensuring that the UoS charging methodology properly takes account of developments in the licensee's distribution business.

The Authority has decided to veto this modification.

Please contact Mark Cox on 0207 901 7458 or Heather Glass on 0207 901 7276 if you have any queries in relation to the issues raised in this letter.

Yours sincerely,

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

Martin Crouch
Director, Distribution

Signed on behalf of the Authority and authorised for that purpose by the Authority