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Cc: Gareth Jones (email only)  
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Date: 2 May 2008

Dear Colleague

### **Authority decision on Use of System Charging Methodology**

Under standard licence condition (SLC) 4 (Use of System Charging Methodology) Independent Power Networks Ltd ("IPNL") is required to have in place a use of system (UoS) charging methodology which has been approved by the Authority<sup>1</sup> and that achieves the relevant objectives<sup>2</sup>.

IPNL is also subject to amended standard licence condition BA1 (Charging Arrangements). Paragraph (3) of this licence condition requires IDNOs to set charges to domestic customers for UoS such that the standing charge, unit rate and other components of the charge shall not exceed the UoS charges to equivalent domestic customers connected to a host DNO's network. This constitutes a relative price control for IDNOs.

On 1 May 2008 IPNL submitted a UoS charging methodology statement to the Authority for its approval.

The Authority has considered IPNL's UoS methodology against both the relevant objectives in SLC 4 and the charging principles outlined in amended standard licence condition BA1. Having carefully considered the issues raised in the statement the Authority has decided to approve IPNL's UoS methodology pursuant to SLC 4(1)(a). This letter sets out the reasons behind the Authority's decision.

IPNL states that for domestic demand customers its UoS charging methodology is to replicate the UoS charges and associated loss adjustment factors for customers in each host DNO's distribution services area in which they own and operate networks.

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

<sup>2</sup> The relevant objectives for the UoS charging methodology, as contained in paragraph 3 of standard licence condition 4 of IPNL's licence are:

- (a) that compliance with the UoS 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 UoS 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 UoS charging methodology results in changes which reflect, as far as is reasonably practicable (taking into account of implementation costs), the costs incurred by the licensee and its distribution business; and
- (d) that, so far as is consistent with sub-paragraphs (a), (b) and (c), the UoS charging methodology, as far as is practicable, properly takes account of developments in the licensee's distribution business.

For non domestic demand and generation customers IPNL states it will generally set its UoS charges so that it replicates the charges of the host DNO. IPNL has clearly stated the specific circumstances where it will not replicate the host DNO's tariffs. In these circumstances it states that will put in place a simpler tariff structure that has the objective to recover the overall charge as would be recovered by the host DNO tariff.

Each DNO has, since February 2005, had in place a UoS charging methodology which has been approved by the Authority. As IPNL's networks, in general, form the final section of the distribution network, in replicating the UoS charges of the host DNO they will broadly reflect the similar costs which IPNL's customers impose on the total distribution network. Consequently, this methodology provides a reasonable proxy to the "all the way" costs. In addition, replicating the host DNO charges ensures compliance with amended standard licence condition BA1 which facilitates competition in supply through maintaining a consistent distribution UoS charge within each distribution services area.

The Authority considers that given the relative size and resources of IDNOs, IPNL's UoS charging methodology provides a practical and efficient way to meet both the requirements of SLC4 and amended standard licence condition BA1.

The Authority further considers that in the specific circumstances where IPNL does not replicate the host DNOs' tariffs for non domestic customers, the overall charge reflects that which the host DNO would levy, and the methodology therefore provides a reasonable proxy for the "all the way" costs.

The Authority has consequently decided to approve IPNL's UoS charging methodology.

IPNL should note that it is under a licence obligation<sup>3</sup> to review this methodology at least once a year and raise any modifications to the methodology as are necessary for the purpose of better achieving the relevant objectives.

If you have any questions surrounding the issues raised in this letter, please contact Mark Askew at [mark.askew@ofgem.gov.uk](mailto:mark.askew@ofgem.gov.uk) or on 0207 901 7022.

Yours faithfully,



**Rachel Fletcher**  
**Director, Distribution**

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

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<sup>3</sup> SLC 4(2)