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CC: Ian Bruce (by email only)

11 March 2009

Dear Colleague,

Decision in relation to Scottish Hydro Electric Power Distribution plc ("SHEPD") connection charging methodology modification proposal 08003: Capacity management for Licensed Distribution Network Operators (LDNOs)

On 12 February 2009, SHEPD submitted a proposal to the Gas and Electricity Markets Authority ("the Authority")¹ to modify its connection charging methodology for its distribution network.

SHEPD has proposed to introduce a new method to deal with capacity requirements for LDNOs, which involves adjustments to its Use of System (UoS) and connection charging methodology statements. This letter refers to the changes made to the connection charging methodology statement.

Having considered the issues raised in the proposal, we have decided **not to veto** the proposed modification.

This letter sets out the background to the modification proposal, summarises the proposed changes and explains our decision.

Background

SHEPD has licence obligations² to have in place as of 1 April 2005 three charging statements: the statement of UoS charging methodology, the statement of UoS charges and the connection charging methodology. The connection charging methodology outlines the method by which connection charges are calculated. SHEPD has a requirement to keep the methodology under review and bring forward the proposals to modify the methodology that it considers better achieves the relevant licence objectives.³

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

² Standard licence conditions 12-13.

³ The relevant objectives for the connection charging methodology, as contained in paragraph 13.3 of standard licence condition 13 of the licence are:

- (a) that compliance with the connection 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 connection 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.

The IDNO working group was established October 2008 to develop common charging arrangements for LDNO customers. The modification reflects the proposal developed as part of this working group.

SHEPD modification proposal

- SHEPD has proposed to outline arrangements for capacity build-up on LDNO networks within its connection charging methodology statement. The proposed addition would state that an LDNO would initially attract UoS based on its demand at the time of connection, and would be allowed to increase its capacity demand up to the limit imposed by the Authorised Supply Capacity (ASC) over a three year period.
- SHEPD has also proposed to provide information relating to the UoS charging methodology statement where provisions for capacity review and capacity reservation in the longer term are outlined.

Ofgem's decision

We have considered this proposal against the relevant objectives and our wider statutory duties. We consider that this modification results in improved clarity to better enable LDNO customers to make an estimate of their likely connection charges. A connection charge based on the predicted total capacity requirement of a fully developed network reflects the costs incurred by SHEPD in its distribution business, and encourages efficient network development. We consider this better achieves SLC 13.3 (d) of properly taking account of developments in the licensee's distribution business. SHEPD has proposed to modify its arrangements for LDNO UoS charges by levying a UoS charge based on current capacity uptake during a specified growth phase. This differs from current arrangements which base UoS charges on the ASC.

The inclusion of a three year capacity review means that there is an incentive on the LDNOs not to overstate long term capacity requirements since SHEPD could reduce the ASC to the capacity requirements at the time of review. In the long term (i.e. beyond the three years) the LDNO would then pay UoS charges based on its total capacity requirements represented by the ASC, which would represent a further incentive to accurately forecast capacity requirements. For these reasons we consider this proposal better achieves SLC 13.3 (d).

It should be noted that the processes and legal tests in relation to modifications and the Competition Act 1998 investigation are separate and distinct. Therefore, in taking this decision, Ofgem does not limit or prejudice any findings which the Authority may make in relation to the current investigation of ENW under the Competition Act 1998.

We have decided **not to veto** the modification to the connection charging methodology statement.

Please contact Karron Baker by email Karron.Baker@ofgem.gov.uk or on 0207 901 7350 if you have any queries relating to issues raised in this letter.

Yours faithfully,



Rachel Fletcher

Director, Distribution

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