

Modification proposal:	Scottish & Southern Energy Power Distribution's¹ (SSE) modification proposal to amend Use of System Charging Methodologies for incorporation of the Common Distribution Charging Methodology (CDCM) (SSEPD/09/03)		
Decision:	The Authority ² directs that this proposal be not vetoed ³		
Target audience:	DNOs, IDNOs, Suppliers, Generators and other interested parties		
Date of publication:	19 February 2010	Implementation Date:	1 April 2010

Background to the proposal

SSE has licence obligations⁴ to have in place three charging statements in relation to use of system (UoS) and connection: the statement of UoS charging methodology, the statement of UoS charges and statement of connection charging methodology and charges. The statement of UoS charging methodology outlines the method by which distribution UoS charges are calculated. SSE has a requirement to keep the methodology under review and bring forward proposals to modify the methodology that it considers better achieve the relevant objectives⁵.

On 20 November 2009, the Authority conditionally approved the Common Distribution Charging Methodology (CDCM)⁶. The CDCM introduces a new methodology for calculating UoS charges for customers connected to Distribution Network Operators' (DNOs) low and high voltage (LV/HV) networks. The CDCM will take effect from 1 April 2010. To facilitate the implementation of the CDCM, DNOs are obliged by their licence to revoke their current LV/HV methodologies by 31 March 2010.

The Authority decided in its Distribution Price Control Review (DPCR5) Final Proposals⁷, published on 7 December 2009, that the calculation of individual revenue pots for calculating demand and generation use of system charges should be replaced by the calculation of a single revenue pot to be recovered from all customers. The Authority also decided to lift an exemption, currently enjoyed by all DNOs, from charging distributed generators (DG) for UoS. The exemption will expire from 31 March 2010. All DNOs have now accepted our Final Proposals in principle⁸.

¹ Scottish and Southern Power Distribution own two electricity distribution licensees – Scottish Hydro Electric Power Distribution and Southern Electric Power Distribution. This letter applies to both licensees.

² The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

³ This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

⁴ Standard licence conditions (SLC) 13 -14.

⁵ The relevant objectives for the UoS charging methodology, as contained in paragraph 3 of SLC 13 of SSE's licences 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 its 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 (after taking 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.

⁶ The Authority's decision document can be found at:

[http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/CDCM%20decision%20doc%20201109%20\(2\).pdf](http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgs/Documents1/CDCM%20decision%20doc%20201109%20(2).pdf)

⁷ A copy of our Final Proposal is on our website. Please see

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=346&refer=Networks/ElecDist/PriceCtrls/DPCR5>

⁸ A press release explaining that DNOs had accepted our Final Proposals in principle was published on 8 January 2010.

Please see http://www.ofgem.gov.uk/Media/PressRel/Documents1/Dp5%20acceptance_1_2010.pdf

As a consequence of the impending implementation of the CDCM and DPCR5 Final Proposals, we asked that each DNO review their extra-high-voltage (EHV) methodologies. DNOs are now bringing forward modifications to their existing EHV methodologies to ensure they better meet the relevant objectives and continue to be clear and effective from 1 April 2010. We also asked DNOs that any necessary modifications, where possible, have a minimal impact on charges ahead of the implementation of the common EHV Distribution Charging Methodology (EDCM)⁹ from 1 April 2011.

SSE's modification proposal, SSEPD/09/003, supersedes their proposal, SSEPD/09/002, which was withdrawn on 18 February 2010. Following discussions with us, SSE's SSEPD/09/003 removed an earlier proposal for charging pre-2005 DG customers in favour of collaboratively developing enduring arrangements with the industry. SSE's latest proposal also corrects the proposed methodology for calculating generation charges in light of the revised method for calculating DG allowed revenue as part of DPCR5.

Summary of SSE's proposals

On 18 February 2010, SSE submitted a modification report to the Authority setting out proposals to modify their UoS charging methodologies, which are intended to reflect changes in the industry – i.e. the impending implementation of the CDCM and DPCR5 Final Proposals from 1 April 2010.

In summary, SSE propose to make the following changes:

- Insert clear references to the CDCM as the methodology for calculation HV/LV charges;
- Clarify how allowed revenue is calculated and recovered through EHV UoS charges in light of DPCR5 Final Proposals;
- Remove the ten per cent cap on increases to EHV DG charges;
- Clarify that in accordance with DPCR5, the exemption from charging pre-2005 DG has been lifted from 1 April 2010 but no charge will be levied until arrangements are developed in collaboration with the industry; and
- A series of housekeeping changes (e.g. updated references to licence conditions).

Reasons for the Authority's decision

The Authority has decided to **not veto** SSE's proposal. In coming to our decision the Authority has considered the proposed modification against the relevant objectives and the Authority's principal objective and wider statutory duties¹⁰.

In general, we consider that SSE's proposals are necessary to ensure that its EHV methodology continues to be clear and operable. We also consider that the changes to charges for EHV customers are generally modest (when compared to current and indicative charges¹¹) and are appropriate for the remaining lifetime of the SLC13 charging methodology before a common charging methodology at EHV (the EDCM) is expected to be introduced on 1 April 2011. In the few circumstances where changes to charges are more significant, when compared to SSE's indicative charges, we expect that SSE should contact these customers to explain what is driving these changes.

Our decision is based on SSE's proposal better achieving relevant objectives (c) and (d). Detailed reasons for the Authority's decisions are set out below.

⁹ DNOs' existing methodologies for calculating UoS charges for use of the higher voltages of their networks – i.e. the EHV are likely to remain in place until the end of 31 March 2011. From 1 April 2011 common EDCMs will replace existing EHV charging methodologies. For further information see our July 2009 decision letter at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=487&refer=Networks/ElecDist/Policy/DistChrgs>

¹⁰ The Authority's statutory duties are detailed mainly in the Electricity Act 1989, Gas Act 1986, Utilities Act 2000, Competition Act 1998, Enterprise Act 2002 and the Energy Act 2004 as well as arising from directly effective E.C. legislation.

¹¹ SSE are obliged by SLC 14 to publish indicative charges, three months ahead of when they are to take effect. In this case, SSE published such charges on 22 December 2009, with the intention that they would take effect from 1 April 2010. SSE published these charges on the assumption that their proposal, SSEPD/09/002, would be implemented.

Relevant objective (c) - that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable (after taking account of implementation costs), the costs incurred by the licensee in its distribution business;

SSE propose to remove a ten per cent cap on increases to charges from one year to the next. The cap was originally introduced to limit volatility in UoS charges to DG (DGUoS) at a time when they were relatively small and therefore very sensitive to changes in a small allowed revenue for DG. SSE consider that removing this cap will improve the cost reflectivity of the charges they calculate.

We consider that the removal of the cap will facilitate the calculation of more cost reflective charges. In particular, the removal of the cap will mean that existing customers' final charges fully reflect the cost signal calculated in accordance with SSE's EHV DG charging methodology and new customers' charges are not unnecessarily inflated/deflated so as to recover revenue that cannot be recovered from existing customers who have their charges capped. Therefore, we consider that SSE's proposal will better achieve relevant objective (c).

Relevant objective (d) – that so far as is consistent with sub paragraphs (a), (b) and (c), the methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's distribution business

As from 1 April 2010, SSE will have in place a new charging methodology for LV and HV (the CDCM), a single allowed revenue pot for both demand and generation customers and will no longer enjoy an exemption from charging pre-2005 DG customers expire. In light of these changes, SSE's proposal makes necessary changes to facilitate these developments in their distribution business.

SSE propose to make incidental changes to their EHV UoS methodology to ensure that it remains clear in light of the impending revocation of its existing HV/LV UoS charging methodologies. In this respect they updated references relating to the calculation of HV/LV charges and have inserted a short new section to their methodology statement that simply describes the CDCM and explains where it can be found.

DPCR5 Final Proposals mean that SSE will have to calculate a single pot of allowed revenue. This will mean that their current EHV UoS methodology for calculating allowed revenues for demand and generation and then scaling EHV demand and generation charges will not be possible. We consider that SSE's proposals represent a practical and clear solution that will enable them to split the single pot of allowed revenue between demand and generation and subsequently correctly calculate EHV charges for demand and generation customers.

In their modification report, SSE recognise that the exemption from charging pre-2005 DG customers will be lifted from 1 April 2010 and that appropriate enduring arrangements will be developed in collaboration with the industry. Following our consultation on Western Power Distribution's modification proposal UOS016, we have given due consideration to responses and other DNOs' proposals in relation to charging pre-2005 DG. We now consider that resolving issues in relation to pre-2005 DG charging would benefit from a collaborative effort amongst the industry. Therefore, we consider SSE's approach is an appropriate way forward.

In light of the impending implementation of the CDCM and DPCR5 Final Proposals, we consider that all of SSE's proposals are necessary and will ensure their EHV methodology reflects resulting changes to their distribution business. Therefore their proposals will better meet relevant objective (d).

Further comments

We are happy that the changes proposed are necessary and will better achieve relevant objectives (c) and (d), however we are concerned at the process that has been followed. We are disappointed that this modification proposal was not received until 18 February given that SSE will publish its final charges today, 19 February.

SSE resubmitted this modification proposal very late in the process as a consequence of an incorrect interpretation of DPCR5 Final Proposals having been identified in their previous submission and developments in our position regarding the process for resolving pre-2005 DG charging. Whilst we recognise that our position on process has evolved we have worked closely with SSE on this matter and therefore expected their resubmission should have been more straightforward. In any case we consider that SSE should have done more to ensure their modification proposal was accurate in the first instance regarding DPCR5 Final Proposals.

If you have any questions relating to the issues discussed in this letter please contact Nicholas Rubin at nicholas.rubin@ofgem.gov.uk or on 020 7901 7176.

Steve Smith

Senior Partner, Local Grids and RPI-x@20

Signed on behalf of the Authority and authorised for that purpose