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| Modification proposal: | Amendment proposal to Scottish and Southern Energy Networks¹ ("SSE") Connection Charging Methodology: Mod 09/004 introduction of the Common Methodology | | |
| Decision: | The Authority's ² decision is that this proposal is not vetoed ³ | | |
| Target audience: | DNOs, IDNOs, Suppliers, Generators and other interested parties | | |
| Date of publication: | 29 July 2010 | Implementation Date: | 1 October 2010 |

Background to the modification proposal

In accordance with standard licence condition ("SLC") 13 of its Electricity Distribution Licence, SSE is required to have in force at all times a connection charging methodology ("Methodology"), which the Authority has approved on the basis that it achieves the relevant objectives⁴. SSE must review the Methodology at least once every year and make such modifications (if any) to the Methodology as are necessary for the purpose of better achieving the relevant objectives.

Each Distribution Network Operator ("DNO") has its own individual connection charging document comprised of its Methodology, its connection charging statement ("Statement") and other information relevant to connecting customers. Although these documents are broadly similar, differences in wording and interpretation have led to inconsistency in connection charging across DNOs. There were also a number of grey areas within the DNOs' Methodologies which have led to a lack of transparency in connection charging.

A lack of consistency and transparency makes it harder for customers to accurately estimate connection charges and, by increasing the uncertainty associated with connection costs, may hinder competition in the connections and distributed generation markets. It is also a contributing factor to a number of disputes being referred to the Authority for determination.

In order to address these issues Work Stream 4 ("WS4"), an industry working group comprising a range of industry stakeholders, was established to develop a common connection charging document ("Common Document"). The aim of the Common Document is to improve consistency in connection charging across DNOs, by providing a largely common set of words and clarifying grey areas in the existing Methodologies.

Each DNO has proposed to adopt a version of the Common Document specific to it. Each proposal includes a proposal to adopt a largely common Methodology ("Common

¹ SSE owns two electricity distribution licensees – Southern Energy Power Distribution and Scottish Hydro Electric Power Distribution. This letter applies to the two 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 The 'relevant objectives' for the connection charging methodology, as contained in paragraph 3 of Standard Licence Condition 13 of the licence are:

- (a) that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by its licence;
- (b) that compliance with the methodology facilitates competition in the 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 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 methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's Distribution Business.

Methodology”) in place of its existing Methodology and a common Statement, in place of the DNO’s existing Statement.

On 21 May 2010 the Authority published a consultation⁵ seeking stakeholders’ views on the DNOs’ proposals. The consultation closed on 2 July 2010. The responses to our consultation were generally supportive of the DNOs’ proposals and can be found on our website⁶. Further background to the DNOs’ proposals can be found in our consultation document.

SSE’s modification proposal

On 29 March 2010, SSE submitted a modification proposal to the Authority to replace the Methodology with the Common Methodology.

Moving to the Common Methodology involves making changes to the wording of the Methodology. As the intent of the Common Methodology (and the wider Common Document) is not to make significant changes to the current connection charging arrangements, the majority of these changes are not material. The changes that the Authority considers are material are listed below.

Conditions to which the Minimum Scheme⁷ is subject: SSE’s Common Methodology makes clear that the Minimum Scheme is subject to a number of conditions that are not included in SSE’s Methodology and removes some conditions that are included in the Methodology⁸.

The Minimum Scheme is based on capital cost: the Methodology does not make clear whether the Minimum Scheme will be designed based on capital cost or whole life costs. SSE’s proposals make it clear that the Minimum Scheme will be based on capital cost rather than whole life cost.

Charge associated with the Minimum Scheme to act as a cap on the connection charge: SSE’s Methodology suggests that where it chooses to connect a customer via an Enhanced Scheme⁹ the customer will be charged based on the estimated connection charge associated with the Minimum Scheme regardless of whether the connection charge associated with the Enhanced Scheme is lower.

SSE’s proposals make clear that where the connection charge associated with the Enhanced Scheme is less than that associated with the Minimum Scheme the connecting customer will benefit from the lower charge.

Definition of Reinforcement: SSE’s Methodology does not define the term Reinforcement. SSE’s proposals define Reinforcement as ‘*assets installed that add capacity (network or fault level) to the existing shared use Distribution System*’, and includes five exceptions where this definition does not apply.

⁵ Electricity distribution proposals for a common connection charging document - <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=722&refer=NETWORKS/ELECDIST/POLICY/DISTCHRGMODS>

⁶ <http://www.ofgem.gov.uk/NETWORKS/ELECDIST/POLICY/DISTCHRGMODS/Pages/DistChrgMods.aspx>

⁷ The Minimum Scheme is the least capital cost scheme (subject to a number of conditions set out in a SSE’s Methodology) to connect a customer.

⁸ For details on the conditions added and removed please see chapter 4 of our consultation document.

⁹ An Enhanced Scheme is any connection scheme in excess of the Minimum Scheme.

Measurement of New Network Capacity ("NNC"): SSE's Methodology does not make clear how NNC should be measured. The Common Methodology defines the Relevant Section of Network that will be considered when measuring NNC and the operational equipment ratings that should be used to measure NNC.

Capitalised Operation and Maintenance ("O&M") charges¹⁰: SSE has updated the assumptions that it uses to derive capitalised O&M charges in line with and the change in the cost of capital from DPCR4 to DPCR5. This has resulted in changes of to the capitalised O&M charge – 20% to 20.9% (generation connections); and 30% to 32% (demand connections).

Reasons for the Authority's decision

The Authority has decided **not to veto** SSE's proposals. In coming to our decision the Authority has considered the proposed modifications against the relevant objectives and the Authority's principal objectives and wider statutory duties¹¹.

In general, we consider that SSE's proposals add consistency and transparency to connection charging while not making any significant changes to the current connection charging arrangements. This will allow customers to better understand and estimate connection charges. In depth discussion of the changes is set out in our summary of consultation responses.

Our decision is based on SSE's proposals better achieving relevant objectives (a), (b) and (c) and not affecting relevant objective (d). The reasons for the Authority's decisions are set out below.

Relevant objective (a) - that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by its licence;

Under SLC 13, the DNOs are obliged to have in force at all times a Methodology that is a *'complete and documented explanation, presented in a coherent and consistent manner, of the methods, principles, and assumptions that apply in relation to connections, for determining the licensee's Connection Charges.'* SSE's proposals add clarity to a number of grey areas of its Methodology, including the Minimum Scheme rule and the definition of reinforcement. The Authority considers that this makes SSE's Common Methodology more complete and coherent than the Methodology. Therefore, the Authority considers SSE's proposals better facilitate the discharge of this obligation.

Under SLC 14.20(c), DNOs must have regard for the principle that Connection Charges *'may include an amount for reinforcement of the licensee's Distribution System that is based on a proportionate share of the costs of such reinforcement and is charged at the time of connection.'* Where the connection charge associated with an Enhanced Scheme is lower than that associated with the relevant Minimum Scheme this is likely to be because the Enhanced Scheme involves reinforcement. The Authority considers that where this occurs, the proportionate manner in which to charge for reinforcement is to

¹⁰ Where the customer requests an Enhanced Scheme, DNOs may levy capitalised O&M charges in respect of costs in excess of the Minimum Scheme. Normally O&M costs are recovered via use of system charges.

¹¹ 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.

allow the customer to benefit from the lower charge. Therefore, the Authority considers SSE's proposals better facilitate the discharge of its obligations under SLC 14.20(c).

Given the Authority's view that SSE's proposals better facilitate the discharge of its obligations under SLC 13 and SLC 14.20, the Authority considers that SSE's proposals better achieve relevant objective (a).

Relevant objective (b) - that compliance with the methodology facilitates competition in the generation and supply of electricity, and does not restrict, distort, or prevent competition in the transmission or distribution of electricity;

The Authority considers that, by adding consistency and transparency to its Methodology, SSE's proposals will better allow customers to understand and estimate connection charges. This may facilitate competition in the connections markets on two counts. First, customers that are better able to understand connection charges may find it easier to make an informed choice between connection providers. Second, independent connection providers will be able to better estimate what non-contestable charges they are likely to be subject to for a given connection scheme. Therefore, the Authority considers that SSE's proposals better achieve relevant objective (b).

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

The Authority considers that, where the connection charge associated with an Enhanced Scheme is lower than that associated with the Minimum Scheme, allowing the customer to benefit from the lower charge will better reflect the costs incurred by SSE. The Authority also considers that the assumptions used by SSE to determine its capitalised O&M charges are more accurate and, therefore, its capitalised O&M charges better reflect the costs incurred by SSE. Therefore, the Authority considers that SSE's proposals 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.

The Authority considers that the DNOs' proposals do not affect the achievement of relevant objective (d).

The Authority's views in respect of the future development of the Common Document are set out in our summary of responses document.

The Authority's decision not to veto SSE's Common Methodology should not in any way be interpreted as any form of approval, guidance or comfort in respect of SSE's compliance with competition law. SSE will need to conduct its own assessment of compliance with competition law and the approval of the Common Methodology is without prejudice to the Authority's ability to investigate and/or take enforcement action in respect of potential infringements of competition law.

If you have any questions relating to the issues discussed in this letter please contact Donald Smith at donald.smith@ofgem.gov.uk or on 0207 901 7483.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Rachel Fletcher', is written over a light grey rectangular background.

Rachel Fletcher,
Rachel Fletcher, Partner, Distribution
Signed on behalf of the Authority and authorised for that purpose