

**To: The Company Secretary
Scottish Hydro Electric Power Distribution Plc (Company No. SC213460)
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ**

**Electricity Act 1989
Section 11**

NOTICE UNDER SECTION 11(3) OF THE ELECTRICITY ACT 1989

The Gas and Electricity Markets Authority (the 'Authority') hereby gives notice pursuant section 11(3) of the Electricity Act 1989 (the 'Act') as follows:

1. The Authority proposes to modify the individual electricity distribution licence held by Scottish Hydro Electric Power Distribution Plc (Company No. SC213460) (the "Licensee") granted or treated as granted under section 6(1)(c) of the Act (the "Licence") by modifying Part A of Charge Restriction Condition 4 (Restriction of Distribution Charges: calculation of the Allowed Pass-Through Items) ("CRC 4") and Charge Restriction Condition 18A (Arrangements for the recovery of costs for an integrated plan to manage supply and demand on Shetland) ("CRC 18A") in the manner set out in the Schedule to this Notice.
2. The effect of these changes will be to allow the Licensee to submit a trial project (Shetland Northern Isles New Energy Solutions (NINES)) as a first phase of the integrated plan that it is required to submit under CRC18A. The trial project will inform the second (and main) part of the integrated plan, including the replacement of the old diesel fired power station at Lerwick, to ensure the best value solution.
3. The reason why the Authority proposes this modification is to:
 - a. correct an error in the Licence whereby CRC4 did not refer to CRC18A, and therefore there was no provision for expenditures approved under CRC18A to be funded; and
 - b. enable the Licensee to explore innovative solutions in collaboration with local stakeholders, as required in the fifth electricity distribution price control review (DPCR5) Final Proposals decision¹. This innovation will explore lower cost and more environmentally friendly alternatives to the replacement of the old diesel fired power station at Lerwick that supplies power for Shetland. This

¹ Chapter 6 of Electricity Distribution Price Control Review Final Proposals - Allowed revenue - Cost assessment (ref. 146/09).

http://www.ofgem.gov.uk/Networks/ElecDist/PriceCntlrs/DPCR5/Documents1/FP_3_Cost%20Assessment%20with%20SS%20comments.pdf

modification will bring into effect the proposals set out in our Shetland Northern Isles New Energy Solutions (NINES) Project Consultation (ref. 100/11) published on 5 August 2011 and our decision letter published on 15 September 2011.

4. A copy of the proposed licence modifications and other documents referred to in this Notice are available (free of charge) from the Ofgem library (telephone 020 7901 1600) or on the Ofgem website (www.ofgem.gov.uk).
5. Any representations or objections to the proposed licence modifications may be made on or before 13 October 2011 to: Anna Rossington, Office of Gas and Electricity Markets, 9 Millbank, London, SW1P 3GE or by email to Anna.Rossington@ofgem.gov.uk.
6. All responses will normally be published on Ofgem's website and held in the Research and Information Centre. However, if respondents do not wish their response to be made public then they should clearly mark their response as not for publication. Ofgem prefers responses in an electronic form so they can be placed easily on the Ofgem website.



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Rachel Fletcher
Acting Senior Partner, Smarter Grids and Governance - Distribution
Duly authorised on behalf of the Gas and Electricity Markets Authority

15 September 2011

Schedule to section 11 Modification

CRC4. Restriction of Distribution Charges: calculation of the Allowed Pass-Through Items

Part A: Calculation of Allowed Pass-Through Items (PT)

- 4.3 For the purposes of Part B of CRC 3, which establishes the calculation of Combined Allowed Distribution Network Revenue, the total amount of the PT term is calculated in accordance with the following formula (in this condition, the Principal Formula):

$$PT_t = LF_t + RB_t - HB_t - IED_t + MPT_t + TB_t + UNC_t$$

- 4.4 In the Principal Formula:

- LF_t** means an amount (whether positive or negative) in Regulatory Year t, as derived from the formula set out in Part B below, representing a licence fee adjustment.
- RB_t** means an amount (whether positive or negative) in Regulatory Year t, as derived from the formula set out in Part C below, representing a business rates adjustment.
- HB_t** means the amount received by the licensee in Regulatory Year t as the result of any direction given by the Secretary of State in accordance with section 184 of the Energy Act 2004 in relation to assistance for high-cost distributors (see also CRC 17 in connection with this).
- IED_t** means an amount in the Regulatory Year t representing the revenue from Use of System Charges received by any Inset Electricity Distributor, but limited to the portion of that revenue that relates to the use of relevant assets owned or operated by that distributor that are situated within the geographical boundaries of the licensee's Distribution Services Area.
- MPT_t** means an amount (whether positive or negative) in Regulatory Year t, as derived from the formula set out in Part D below, representing an adjustment for any other pass-through items.
- TB_t** means the amount of pass-through revenue for Regulatory Year t, representing an adjustment in respect of Transmission Connection Point Charges, as derived from the formula set out in Part E below.
- UNC_t** means an amount in Regulatory Year t representing a relevant adjustment to the calculation of Allowed Demand Revenue arising from the application of either CRC 18 (Arrangements for the recovery of uncertain costs) or CRC18A (Arrangements for the recovery of costs for an integrated plan to manage supply and demand on Shetland).

CRC 18A. Arrangements for the recovery of costs for an integrated plan to manage supply and demand on Shetland

Introduction

- 18A.1 This condition requires the licensee to propose a trial of innovative options (“the Shetland Trial”) and an integrated plan (that is informed by the Shetland Trial) to manage the supply and demand of electricity on Shetland (“the Integrated Plan for Shetland”).
- 18A.2 This condition also requires the licensee to propose an incentive mechanisms to accompany the Shetland Trial and the Integrated Plan for Shetland.
- 18A.3 This condition enables the licensee, when proposing the Shetland Trial and the Integrated Plan for Shetland and the relevant incentive mechanisms, also to propose, and the Authority to determine, such adjustments to the Charge Restriction Conditions as are necessary to enable the licensee to recover its Shetland Trial Costs and Shetland Integrated Plan Costs.
- 18A.4 This condition allows the Authority to review the Shetland Trial Costs and Shetland Integrated Plan Costs incurred, or likely to be incurred, by the licensee and, if appropriate, to direct that an adjustment be made in respect of them.
- 18A.5 This condition also allows the Authority to seek a competitive tender to manage supply and demand on Shetland if the licensee does not propose the Integrated Plan for Shetland within the timeframe set out in paragraph 18A.7 18A.10 below.

Part A: Shetland Trial Costs and Shetland Integrated Plan Costs

- 18A.6 For the purposes of this condition, Shetland Trial Costs and Shetland Integrated Plan Costs:
- (a) are costs that are incurred, or likely to be incurred, reasonably and efficiently by the licensee in the delivery and management of the Shetland Trial and the Integrated Plan for Shetland; and
 - (b) are not otherwise recoverable by the licensee under or pursuant to any of the Charge Restriction Conditions of this licence.

Part B: Licensee’s ability to propose a relevant adjustments

- 18A.7 The licensee must present the Shetland Trial to the Authority by 31 October 2011 (or such later date with the consent of the Authority).
- 18A.8 When presenting the Shetland Trial under paragraph 18A.7 above, the licensee, by Notice to the Authority, and in accordance with Part C below:
- (a) must propose a relevant incentive mechanism; and
 - (b) must also propose relevant adjustments to the Charge Restriction Conditions, in respect of the Shetland Trial Costs.

18A.9 A relevant adjustment is one which the licensee believes would have the effect of enabling it to recover any of the Shetland Trial Costs that would otherwise not be recoverable under the Charge Restriction Conditions.

~~18A.7~~ 18A.10 The licensee must present the Integrated Plan for Shetland to the Authority by 31 ~~January~~ July 2013.

~~18A.8~~ 18A.11 When presenting the Integrated Plan for Shetland under paragraph ~~18A.7~~ 18A.10 above, the licensee, by Notice to the Authority, and in accordance with Part C below:

- (a) must propose a relevant incentive mechanism; and
- (b) ~~may~~ must also propose ~~a~~ a relevant adjustments ~~s~~ to the Charge Restriction Conditions, in respect of the Shetland Integrated Plan Costs.

~~18A.9~~ 18A.12 A relevant adjustment is one which the licensee believes would have the effect of enabling it to recover any of the Shetland Integrated Plan Costs that would otherwise not be recoverable under the Charge Restriction Conditions.

Part C: Other provisions relating to the licensee's proposals

~~18A.13~~ The Authority will not consider the Shetland Trial or determine a relevant incentive mechanism if the Shetland Trial and a relevant incentive mechanism are not both presented by the licensee by 31 October 2011 (or such later date with the consent of the Authority) in accordance with Part B above.

~~18A.10~~ 18A.14 The Authority will not consider the Integrated Plan for Shetland or determine a relevant incentive mechanism if the Integrated Plan for Shetland and a relevant incentive mechanism are not both presented by the licensee by 31 ~~January~~ July 2013 in accordance with Part B above.

~~18A.11~~ 18A.15 The Authority will not determine any relevant adjustment if it is not proposed either:

- (a) together with the Shetland Trial and the relevant incentive mechanism by the licensee by 31 October 2011 (or such later date with the consent of the Authority) in accordance with Part B above; or
- (b) together with the Integrated Plan for Shetland and the relevant incentive mechanism by the licensee by 31 ~~January~~ July 2013 in accordance with Part B above.

~~18A.12~~ 18A.16 A Notice served by the licensee under Part B above must in all cases:

- (a) state the obligations or requirements to which the Notice relates;
- (b) set out by reference to each such obligation or requirement the basis on which the licensee has calculated the relevant adjustment;
- (c) state the date from which the licensee wishes the Authority to agree that the relevant adjustment will have effect ("the adjustment date") which must not be a date earlier than: 1 October 2013;

- i. 1 April 2012 for the Shetland Trial Costs; and

ii. 1 April 2014 for the Shetland Integrated Plan Costs;

- (d) include the licensee's Shetland Trial or Integrated Plan for Shetland; and
- (e) include a relevant incentive mechanism.

Part D: Authority's determination of the incentive mechanism and any relevant adjustment

~~18A.13~~ 18A.17 Where the licensee serves a Notice under Part B, subject to Part C above, the Authority may, within one month for the Shetland Trial and within four months for the Integrated Plan ~~of the close of the second application window set out in paragraph 8(b) of CRC 18 (Arrangements for the recovery of uncertain costs),~~ determine the relevant incentive mechanism and any relevant adjustments ~~(if one is proposed)~~ to the Charge Restriction Conditions in such manner as it considers appropriate, subject to paragraph ~~18A.14~~ 18A.18. The Authority may determine conditions ("relevant conditions") that the licensee must fulfil when undertaking the Shetland Trial or the Integrated Plan for Scotland.

~~18A.14~~ 18A.18 In determining the relevant incentive mechanism, ~~and~~ any relevant adjustment and any relevant conditions under this Part D, the Authority must:

- a. consult with the licensee;
- b. have particular regard to the purposes of this condition; and
- c. take no account of the financial performance of the licensee relative to any of the assumptions, whether express or implied, by reference to which the Charge Restriction Conditions may have been framed.

~~18A.15~~ 18A.19 The provisions of Part E below are also relevant to the Authority's use of its power of determination under this Part D.

Part E: Other provisions relating to the power of determination

~~18A.16~~ 18A.20 The power of the Authority to determine a relevant incentive mechanism or a relevant adjustment under Part D is a power to confirm, reject or vary the relevant incentive mechanism proposed by the licensee and any relevant adjustment if one is proposed by the licensee.

~~18A.17~~ 18A.21 Without prejudice to paragraph ~~18A.16~~ 18A.20, a determination by the Authority of a relevant adjustment may include such adjustments as it thinks fit in respect of Shetland Trial Costs or Shetland Integrated Plan Costs likely to be incurred in subsequent Regulatory Years.

Part F: Licensee's right to implement a relevant incentive mechanism or make a relevant adjustment

~~18A.18~~ 18A.22 If the Authority has not determined the relevant incentive mechanism and (if applicable) relevant adjustment proposed by the licensee within four months of the ~~close of the second application window set out in paragraph 8 (b) of CRC 19~~ Integrated Plan submission date, and that Notice has not been withdrawn, the licensee may give Notice to the Authority that the relevant incentive mechanism and (if applicable) relevant adjustment

will take effect from the adjustment date for all relevant purposes under the Charge Restriction Conditions.

Part G: Authority's discretion to initiate a review

~~18A.19~~ 18A.23 If a Notice is not served by the licensee in accordance with Parts B and C above, the Authority may initiate a review of the Shetland Integrated Plan Costs the licensee has incurred or is likely to incur.

~~18A.20~~ 18A.24 Subject to the conclusion of that review, the Authority may:

- (a) direct that an adjustment be made in respect of any Shetland Integrated Plan Costs incurred, or likely to be incurred, by the licensee during any Regulatory Year;
- (b) seek a competitive tender to manage supply and demand on Shetland; or
- (c) do both (a) and (b).

Part H: Treatment of a relevant adjustment

~~18A.21~~ 18A.25 The total amount of any relevant adjustment or adjustments in respect of any Regulatory Year t, whether determined by the Authority or made by the licensee under this condition, is to be treated (so far as it is possible to do so) as an adjustment to the amount of the term UNCT for the purposes of the calculations for which CRC4 (Restriction of Distribution Charges: calculation of the Allowed Pass-Through Items) makes provision.