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*Promoting choice and value for
all gas and electricity customers*

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Date: 16 July 2012

Dear Amanda

Approval of payments to related undertakings for Orkney Energy Storage Park

On 19 June 2012 you submitted a First Tier Low Carbon Networks (LCN) Project Registration Pro-forma (pro-forma) for an LCN Fund project - "Trial of Orkney Energy Storage Park" (the Project).

1. Approval of payments to related undertakings

Paragraph 3.10 of Section One of the LCN Fund Governance Document v5 (the Governance Document) requires you to declare any payments that are to be made to any related undertaking at the time of project registration. In the pro-forma, you declared that the Project involves payments of up to £1.047 million to SSE Generation, a related undertaking. These payments require our approval before the Project can be registered.

We require DNOs to ensure value for money for consumers when making payments to related undertakings. We note that you undertook a competitive process to select the storage provider. The details of the tender process that you have set out in the Annex to the pro-forma submitted on the 19 June 2012 confirm that the tender was run in a fair manner and in accordance with best industry practice. We consider that you have sought to ensure best value for money to consumers in developing and delivering the Project.

We therefore approve the proposed payments to a related undertaking in accordance with the Governance document. However, we ask you to note that whilst you can reduce the level of payment that you have registered for the Project, you cannot increase this payment or make a payment to an additional related undertaking without receiving our approval.

2. Offering terms to similar Distribution System Users

Paragraph 3.10 of Section one of the Governance Document also requires DNOs making payments to related undertakings to use reasonable endeavours to identify similar Distribution System Users in the same area and offer them the same terms. This requirement is in place to ensure DNOs offer the same terms to all Distribution System Users facing similar circumstances, for example for connection to the Distribution System.

The Project involves installing and managing a third party storage provider. The project will put in place a commercial agreement to make payments to the storage provider to reduce system constraints. This situation was not envisaged when the requirements of the Governance Document were put in place. We also recognise that the terms of such a

contract, agreed following a tender process, are commercially sensitive. Therefore we do not require you to offer these terms to similar Distribution System Users. We intend to update the drafting of the Governance Document to reflect the circumstances of the Project and other similar First Tier LCN Fund Projects following this year's Second Tier competition.

If you have any questions on this letter, please contact Sam Williams on 020 7901 0532 or by email at Sam.Williams@ofgem.gov.uk.

Yours sincerely,

A handwritten signature in blue ink that reads "Andy Burgess". The signature is written in a cursive style with a large initial 'A'.

Andy Burgess
Associate Partner, Transmission and Distribution Policy