Company Secretary
SP Distribution Limited
3 Preston Way
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Promoting choice and value for all gas and electricity customers

Direct Dial: 020 7901 7159
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Date: 21 December 2012

Dear Company Secretary,

Derogation extension pursuant to paragraph 13B.14 of Standard Licence Condition 13B (EHV Distribution Charging Methodology) of the Electricity Distribution Licences of SP Distribution Limited and SP Manweb plc

I refer to your letter of 5 November 2012 requesting an extension to the derogation granted in our letters of 19 December 2011[1]. This derogation was granted pursuant to paragraph 13B.14 of the Electricity Distribution Licence (the "Licence"), in respect of the requirements of paragraph 13B.4 relating to the Extra High Voltage Distribution Charging Methodology (the "EDCM"). Paragraph 13B.4 provides that the Licensee must at all times implement and comply with the EDCM. The EDCM is detailed in the Distribution Connections and Use of System Agreement (DCUSA) document.

Areas of non compliance against the EDCM for demand customers

The present derogation applies to the two distribution licensees of Scottish Power Energy Networks (SPEN), SP Distribution Limited and SP Manweb plc. It relieves them of their obligation to comply with the way that Sole Use Asset (SUA) costs are levied on certain EHV[2] demand customers.[3] The present derogation applies to those customers that paid capitalised operating & maintenance (O&M) costs at the time of connection that have not yet expired. SPEN believes that these customers should be exempt from paying the O&M element of SUA costs to avoid paying twice for the same service. You have told us that SP Manweb plc has nine such customers, and that SP Distribution Limited has seven.

The present derogation was granted for a period of one year, expiring on 31 March 2013. You have requested that we extend the derogation from 1 April 2013. You have proposed that we do so on a customer-specific basis until the period for which O&M has been paid expires. These periods are either 15 or 20 years from the date of connection.

Information provided by SPEN

[1] See out two letters of 19 December 2011: http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Documents1/SPD%20Derogation%20final%2019 1211.pdf and http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistChrgMods/Documents1/SP%20Manweb%20Derogation%20final%20191211.pdf
[2] EHV refers to customers connected at the extra high voltage level of the distribution network
[3] SUA costs are discussed in "Schedule 17 – EHV Charging Methodology (FCP Model)" of the DCUSA document.

We have considered the information provided by SPEN in reaching our decision on the request to extend this derogation. We note that SPEN advised us that -

- The approved EDCM methodology does not take into account any historical capitalised O&M paid by EDCM import customers. This means that customers that have already paid charges relating to O&M would pay again through EDCM charges. The derogation request would prevent this and result in more cost reflective tariffs.

- The revenue that would have been generated from these charges will, as appropriate, be recovered from all EDCM demand customers in the respective DNO's area. These reallocated charges are very small relative to the total amount to be recovered (the "EDCM revenue pot").

- The derogation will not affect security of supply, competition or health and safety.

The Authority's decision

We have considered SPEN's request in accordance with our principal objective and statutory duties in light of the information provided by SPEN. We have considered, in particular, the principle underpinning the derogation request and those factors set out in the Guidance Note "Derogation from codes and standards in electricity generation, supply, and distribution and transmission licenses"[4]. We have decided to grant an extension to the derogation from the way that SUA charges are levied on EDCM customers as described in "Schedule 17 – EHV Charging Methodology (FCP Model)" of the DCUSA document. This is because we agree with the principle of preventing double charging of EDCM customers during the transition between the previous methodologies and the EDCM.

We also note that the charges are small relative to the size of the EDCM revenue pot. Therefore, the impact upon charges for other EDCM customers in the two DNOs' areas will be small. As such, we do not think there is a need to remove these costs from the EDCM pot, and it should be calculated as per the usual method.

Duration of the derogation

Under SPEN's proposal, the derogation would be in force until 2024 for some customers. However, we do not think that it is good practice for a derogation to be a long term solution. The present derogation was granted for one year (2012/13), with the understanding that SPEN would address this issue in an enduring manner. We think the appropriate route would be to raise a modification proposal through the EDCM open governance arrangements. This would ensure that this issue is addressed within the methodology itself, to preserve the principle of having a common charging methodology for all DNOs. It would also make the methodology for charging these customers more transparent and ensure that any changes to the methodology take this issue into account. You have told us that this issue applies to no other DNOs. However, we do not see why this is a material issue. The methodology modification can be drafted in a way that means it only applies to customers in these circumstances. If SPEN does not consider this approach is appropriate then we would be keen to understand why. We welcome discussions with SPEN on its plans for a long term solution and why these are appropriate.

Therefore, we are granting this extension to the derogation for a period of one year. Please refer to the Direction below.

Direction

[4] http://www.ofgem.gov.uk/Networks/Techn/TechStandds/Derogtns/Documents1/090119DerogationsGuidance.pdf

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9 Millbank London SW1P 3GE **Tel** 020 7901 7000 **Fax** 020 7901 7066 **www.ofgem.gov.uk**

The Authority hereby directs, pursuant to paragraph 14 of standard condition 13B of the Licence, that SP Distribution Limited and SP Manweb plc are relieved of their obligation under paragraph 4 of standard condition 13B of the Licence in respect of the way SUA charges are levied on EDCM customers as described in “Schedule 17 – EHV Charging Methodology (FCP Model)” of the DCUSA document.

This Direction shall have effect from and including 1 April 2013 and shall remain in effect up to and including 31 March 2014, or such other time as the Authority shall revoke or vary the Direction in writing upon reasonable notice.

This letter constitutes a notice for the purposes of section 49A of the Electricity Act in relation to the Direction.

Please contact Bimbola Ayo (e-mail: Bimbola.ayo@Ofgem.gov.uk, tel: 0207 901 7184) if you have any queries relating to the issues raised in this letter.

Yours sincerely,

Andrew Burgess
Associate Partner, Transmission and Distribution Policy
For and on behalf of the Gas and Electricity Markets Authority

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