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26 June 2008

To the Company Secretary

Approval of statement pursuant to special condition J10 (Basis of Transmission Owner Charges) of Scottish Hydro-Electric Transmission Ltd's (SHETL's) transmission licence.

This letter sets out the Authority's decision to approve the statement at Annex 1 of this letter pursuant to special condition J10 (Basis of Transmission Owner Charges) of SHETL's electricity transmission licence.

Background

Under its Electricity Transmission Licence, SHETL is required to have a statement, approved by the Authority, setting out the basis upon which they will charge National Grid Electricity Transmission Plc (NGET) for the services provided. The services comprise:

- Transmission owner services;
- Connections to the licensee's transmission system; and
- Outage charges.

Pursuant to Special Condition J10 of SHETL's electricity transmission licence, SHETL shall, at least once in every year, make necessary revisions to these statements in order that the information set out in the statements shall continue to be accurate in all material respects.

SHETL submitted its modified statement of the basis of transmission owner (TO) charges for approval from the Authority on 4 March 2008. We published this statement¹ and invited wider views on the modifications on 4 April 2008. These views were sought by 2 May 2008.

The modifications were predominately of a housekeeping nature. However, we noted that there were some additions relating to abortive works and clarifications on contestable connection works. Increases were also made to the indicative connection asset charges contained in appendix 1 and the personnel charge-out rates described in appendix 3.

¹ Consultation available on Ofgem website:
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=68&refer=Networks/Trans/ElecTransPolicy/Charging>

On 29 April, SHETL submitted a supplementary letter highlighting a housekeeping error in that a section titled "Self build option" was to be replaced by the new text regarding contestable connection works. An oversight meant the original section had not been removed from the statement.² As the oversight did not affect the intention, principles or detail of the statement (or any modifications made to it) we felt that it did not influence the outcome of the consultation and as such did not feel it necessary to amend the consultation period.

Respondents views

We received one response to our consultation. This was from NGET and was not marked as confidential³. The points raised specifically regarding SHETL's statement are discussed below and are followed by a number of more general observations concerning the TO charging statements.

Clarification

NGET requested greater clarity on the basis upon which indicative and fixed price offers are made to aid the process for reconciling connection charges.

Contestable connection works

NGET noted that the additional text on page 11 regarding contestable connection works was repetitious of the text on page 14, headed "Self Build Option" and should be deleted.

General points

NGET also raised a number of more general points regarding both SHETL's and Scottish Power Transmission Ltd's (SPT's) charging statements. NGET remain concerned over the potential for mismatches between NGET and TO revenues arising from the differing treatments of items such as rates of return, post-vesting connection assets, site-specific maintenance, transmission costs and application fees. NGET made the point that it has raised these concerns during previous consultations but greater consistency between both SHETL's and SPT's charging statements and between the TO's statements and NGET's has not been achieved to date.

Governance

NGET also commented on the governance framework of the TO charging statements, in particular the prescribed process for amending them. NGET argued that the TO charging statements should be subject to similar governance processes to the GB methodology (of which NGET is the custodian). This would require the respective TO's to conduct their own consultations on changes to the statements within defined timescales ahead of the charging year. As such, NGET would welcome a licence change to align the three transmission charging methodologies as they see no reason for there to be any difference in governance arrangements.

Ofgem response to views

Clarification

We sought clarification from SHETL on the points raised by NGET concerning the basis for fixed and indicative price offers. SHETL responded by confirming that offers were based on

² This letter can be found at the transmission charging pages of Ofgem's website:

<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Pages/Chrgng.aspx>

³ NGET's response available on the transmission charging pages of the Ofgem website:

<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Pages/Chrgng.aspx>

two types of offer. The first relates to fixed price offers, whereby SHETL gives a fixed cost for providing connection works which does not change, and the second relates to indicative offers whereby SHETL provide an early cost for providing the connection using best information available at the time. This subsequently becomes fixed at least 6 months prior to commencement of works. Following this clarification, and in light of NGET's concerns over consistency, we felt it necessary to discuss the basis of offers provided by the TO's and NGET in more detail at the May 2008 meeting of the Charging User Group (ChUG). This discussion clarified each TO's basis for the types of offers available. However, it transpires that each TO's approach is both different to the other TO and different to the types of offers used by NGET.

As such we have requested that the three parties undertake a process whereby the full extent of the differences is established and presented to industry for its view. Should it be necessary and appropriate, this may lead to changes to the TO charging statements being brought forward for approval for the charging year 2009/10.

Contestable connection works

We note that this has been updated and the repetition removed.

General points

We note NGET's concerns regarding possible mismatches between TO and NGET revenues. We are of the view that there should, where appropriate, be consistency in the treatment of items such as those listed above, although we recognise that in some cases there are differences which are justifiable and correct. However we are concerned that there are items which appear to be treated inconsistently without appropriate justification. We will look to these being clarified and addressed by the licensees over the forthcoming months for inclusion in next year's charging statements.

Governance

We further note NGET's views on the governance arrangements for the TO statements. We recognise that changing the arrangements to bring them into line with those in place for the GB methodology may improve transparency; however we are of the view that the two documents are different in function and as such may be governed differently. The TO charging statements are the mechanism by which the TO's inform NGET of how they are to calculate the amount of revenue they will recover from NGET each charging year, in line with the allowances under the Transmission Price Control Reviews (TPCR) and principles of the GB methodology. Therefore despite the issues identified by NGET that need to be addressed, there is no convincing case, as yet, for changing the governance arrangements. However, this does not preclude future changes were circumstances to change or more compelling arguments presented.

Authority's Decision

We have considered whether the draft statement submitted by SHETL is consistent with the requirements of special condition J10 and SHETL's wider licence and statutory obligations. On balance the Authority has concluded that, following some minor housekeeping changes, the draft statement is consistent with these obligations. Similarly, the Authority has had regard to its principal objective and general duties in considering the draft statement and concludes that approval of the draft statement is consistent with them.

However, the Authority notes that there are a number of areas that should be addressed as a priority to further improve the clarity and consistency of the TO charging statements. For clarity, those areas are the basis of offers and improving consistency (where appropriate) in the treatment of certain of the revenue constituents of the TO's. The Authority expects that these areas will be concentrated on over the forthcoming months and any amendments presented for its consideration in the charging statements for 2009/10. The Authority

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expects these to be agreed and in place in time for the start of charging year on 1 April 2009.

Pursuant to paragraph 6 of special condition J10 of SHETL's transmission licence, the Authority hereby approves the draft Statement of the Basis of TO Charges at Annex 1 of this letter.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Stuart Cook', is written over a long, thin horizontal line that extends to the right.

Stuart Cook
Director, Transmission
Duly authorised on behalf of the Authority

cc. Mo Sukumaran