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value for all customers*

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Dear Company Secretary

Approval of statement pursuant to special condition J10 (Basis of Transmission Owner Charges) of Scottish Power Transmission Ltd's (SPT'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 SPT's electricity transmission licence.

Background

Under its Electricity Transmission Licence, SPT 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 SPT's electricity transmission licence, SPT 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.

SPT submitted its modified statement of the basis of transmission owner (TO) charges for approval from the Authority on 31 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 made to the statement included those of a housekeeping nature as well as more comprehensive additions and changes. These additions and changes mainly related to charges for abortive works and arrangements for contestable connection works. There were also increases in the fees described in Appendices A-D relating to application fees, engineering personnel rates and indicative connection charges.

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

Respondents' views

We received one response to our consultation. This was from NGET and was not marked as confidential.² The points raised specifically regarding SPT's statement are discussed below and are followed by a number of more general observations made concerning the TO charging statements.

EXS_t term

NGET stated their continued reservations on the meaning of the term EXS_t in the SPT statement. They are of the view that, although there have been a number of information exchanges, they remain unclear as to which costs are being recovered through Site Specific Charges and which are being recovered under the EXS_t term. NGET also are of the view that SPT's interpretation appears to contrast with that of the other TO, Scottish Hydro Electric Transmission Ltd (SHETL).

NGET note that a consistent approach would be beneficial as it would reduce the potential for future mismatches in revenue.

Application of the connection charging boundary

NGET welcomed SPT's adoption of the definition of the connection charging boundary used in both the NGET and SHETL charging statements. NGET raised concerns, however, over the application of this definition by SPT, in particular the use of a "Collector Substation" concept to which alternative boundaries and charging arrangements apply. NGET note that if such a concept is being used, it is not defined in the charging statement.

General points

NGET also raised a number of more general points regarding both SPT's and SHETL'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 SPT's and SHETL'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 argue that the TO charging statements should be subject to similar governance processes to the GB methodology (of which they are 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

EXS_t term

We note NGET's concerns over the allocation of asset costs between the EXS_t term and Site Specific Charges. We are also aware of the discussions and information exchanges that have occurred at meetings of the Charging User Group (ChUG) which have taken place to try to improve the general understanding of such cost allocations.

² 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>

We consider that, wherever possible and appropriate, consistency in TO treatment of costs and their allocation should be aimed for. As such we look to SPT and NGET to clearly define which and how costs are allocated to EXS_t and Site Specific Charges. Once this is achieved, the two TO's and NGET should work to improve the consistency between their respective approaches, with the aim of reducing the possibilities of future mismatches in revenue. This work should be undertaken over the forthcoming months and any changes or points of clarification should be made for inclusion in the charging statement for charging year 2009/10.

Application of the connection charging boundary

We note NGET's comments on SPT's apparent use of a collector substation approach to defining the connection boundary at some sites. This issue is being considered by Ofgem through other channels and subject to the outcome of this consideration, it may be appropriate for SPT to propose an amendment to its charging statement to clarify this definition. We note that, under SLC J10 of their transmission licence, this may be done at any point during the charging year and submitted to the Authority for approval.

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 year 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 SPT is consistent with the requirements of special condition J10 and SPT's wider licence and statutory obligations. On balance the Authority has concluded that, following some minor housekeeping changes and, 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 revenue constituents of the TO's. In addition, we note that it may be appropriate to amend the connection charging boundary definition, subject to the outcome of work being taken forward separately. 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 expects these areas to be agreed and appropriate arrangements put in place in time for the start of charging year on 1 April 2009.

Pursuant to paragraph 6 of special condition J10 of SPT'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', with a long horizontal line extending to the right.

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

Cc, Maria Liendo