



Department  
of Energy &  
Climate Change

# Hydro Benefit Replacement Scheme & Common Tariff Obligation

Three year review of statutory schemes:  
consultation

December 2015

The consultation can be found on DECC's website:

<https://www.gov.uk/government/consultations/hydro-benefit-replacement-scheme-and-common-tariff-obligation-three-year-review-of-statutory-schemes-consultation>

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# 1. General information

## **Purpose of this consultation:**

There is a requirement for the Government to review the Hydro Benefit Replacement Scheme and the Common Tariff Obligation every three years. This consultation forms part of the review process, and views are invited from any interested parties on whether the schemes continue to meet their policy objectives and are operationally effective. Views are also invited on the best way to deliver a revised funding arrangement for the Shetland cross-subsidy from around 2019 onwards, which will have the effect of reducing costs for all consumers in the North of Scotland.

**Issued:** 23<sup>rd</sup> December 2015 **Respond by:** 17<sup>th</sup> February 2016

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Consultation reference: URN 15D/548

## **Territorial extent:**

Great Britain.

## **How to respond:**

Your response will be most useful if it is framed in direct response to the questions posed, though further comments and evidence are also welcome. Where possible, responses should be sent electronically to the e-mail address above. Hardcopy responses sent to the postal address above will also be accepted.

## **Additional copies:**

You may make copies of this document without seeking permission. An electronic version can be found at <https://www.gov.uk/government/consultations/hydro-benefit-replacement-scheme-and-common-tariff-obligation-three-year-review-of-statutory-schemes-consultation>. Other versions of the document in Braille, large print or audio-cassette are available on request. This includes a Welsh version. Please contact us under the above details to request alternative versions.

## **Confidentiality and data protection:**

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request.

We will summarise all responses and place this summary on the [GOV.UK website](#). This summary will include a list of names or organisations that responded but not people's personal names, addresses or other contact details.

**Quality assurance:**

This consultation has been carried out in accordance with the [Government's Consultation Principles](#).

If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

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## 2. Introduction

### 2.1. Purpose of these statutory schemes

1. The particular challenges of electricity supply in the North of Scotland – primarily related to the relatively large and sparsely populated terrain – mean that it costs more to distribute electricity here than elsewhere. The following paragraphs describe several complementary Government measures that ensure consumers in the North of Scotland do not bear an unreasonable burden of these electricity distribution costs. In combination with the lowest electricity transmission<sup>1</sup> charges for demand in GB, these measures mean that overall electricity network charges for households in the North of Scotland are similar to two other GB regions (see Annex).
2. The Hydro Benefit Replacement Scheme protects domestic and non-domestic consumers from the high costs of distributing electricity in the North of Scotland. In 2015/16, it is providing an assistance amount of £57m to the North of Scotland, which is worth around £41 per household. The scheme is funded by charges on all licensed suppliers across Great Britain. It was commenced under a power in section 184 of the Energy Act 2004.
3. The Common Tariff Obligation ensures electricity suppliers in the North of Scotland are not able to charge comparable domestic consumers different prices solely on the basis of their location within the area. This is designed to protect consumers in remote rural areas or islands from the relatively high costs of supplying electricity in these areas. It became law under *the Electricity Act 1989 (Uniform Prices in the North of Scotland) Order 2005*.
4. The Common Tariff Obligation also helps to underpin a cross-subsidy arrangement for most electricity consumers on Shetland, who would otherwise face significantly higher electricity prices than comparable consumers on the mainland. This cross-subsidy amounted to £28.5m in 2014/15<sup>2</sup>. The resulting costs are currently spread across all consumers in the North of Scotland, but these are expected to increase from around 2019<sup>3</sup> onwards due to the need to implement a new energy solution for Shetland. In light of the potential cost increase that this could involve, the Government confirmed in March 2015<sup>4</sup> that the full costs of the cross-subsidy for Shetland would be spread over Great Britain from the date at which the new energy solution for Shetland is implemented. This change will have the effect of reducing costs for *all* consumers in the North of Scotland.

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<sup>1</sup> Electricity networks are divided into the high voltage transmission network, which takes electricity around GB, and the lower voltage distribution networks which connect customers to the national transmission network. National Grid operates the transmission network (and owns the network in England & Wales, and Scottish Power and Scottish and Southern Energy (SSE) own the network in Scotland). There are 14 regional distribution network operators, including SSE for the North of Scotland.

<sup>2</sup> Source: Ofgem

<sup>3</sup> Subject to the development of the competitive process to implement a new energy solution for Shetland <https://www.ssepd.co.uk/ShetlandEnergy/>

<sup>4</sup> *Government Response to consultation on non-domestic electricity consumers on Shetland* (DECC, March 2015).

## 2.2. Why the schemes are being reviewed

5. The Energy Act 2004 requires the Hydro Benefit Replacement Scheme to be reviewed every three years, with the last review undertaken in 2012/13. A Ministerial commitment was made to review the working of the Common Tariff Obligation in parallel with the Hydro Benefit Replacement Scheme review. In addition, the following announcement was made in the March 2015 Budget<sup>5</sup>:

*The Government will consult on reducing electricity distribution costs for consumers in the North of Scotland, to ensure that they pay no more for electricity distribution than consumers in the next most expensive region. The Government estimates that this could save an average household in the North of Scotland around £30 per year on their electricity bill.*

6. Given the clear read-across between the Budget 2015 announcement and the review of the Hydro Benefit Replacement Scheme, the Government has decided to progress consideration of both through this consultation.
7. For the Shetland cross-subsidy, the Government needs to determine the most appropriate mechanism to recover costs from all GB consumers once a new energy solution for Shetland has been implemented. This consultation provides the opportunity to make this decision.
8. The Government's proposed approach on these points is set out in this consultation document, and we would welcome views from any interested parties by 16<sup>th</sup> February 2016.

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<sup>5</sup> *Budget 2015*, paragraph 1.217 (HM Treasury, March 2015)

## 3 Policy background

### 3.1. Electricity distribution charges

9. As with other types of network charge, electricity distribution charges vary regionally to reflect the costs of running the network in a specific area and the number of consumers those costs are spread across. This cost reflective approach helps to minimise overall network costs by ensuring that each network company has to account to its local stakeholders for the costs it has incurred. In addition, it means that local stakeholders will pay directly for those electricity distribution upgrades undertaken on their behalf, rather than consumers as a whole picking up the costs, as would happen under a single national network charge. Ofgem recently published an analysis of regional differences in network charges<sup>5</sup>, and found no compelling case from a regulatory perspective to move to a national network charge. Ofgem also confirmed that Government would have to play a leading role in a decision to change from the current approach, given the nature of the policy issues raised.
10. As noted earlier, the particular challenges of electricity supply in the North of Scotland mean that electricity distribution costs are higher here than elsewhere. However, the Hydro Benefit Replacement Scheme reduces the differential in electricity distribution charges between the North of Scotland and the next highest regions by more than half. The Government also welcomes the fact that electricity distribution charges have fallen over the last year in nearly all electricity distribution regions, including the North of Scotland, as a result of Ofgem's RIIO price control<sup>6</sup>. For GB as a whole, there has been an average reduction in electricity distribution charges per household of £11 from 2014/15 to 2015/16, whilst the North of Scotland has seen an £18 reduction<sup>7</sup>.
11. A further consideration is that consumers in the North of Scotland benefit from the lowest electricity transmission charges in GB. When electricity transmission and distribution are combined, charges for the North of Scotland are similar to those for two other GB regions.
12. The Government recognises the real concerns affecting those households – particularly in rural areas of the North of Scotland – who are off the gas grid and therefore rely on fuels other than mains gas for their heating. However, the Government does not believe that a region-wide network subsidy provides an efficient or effective way of targeting support at a specific group of consumers within a region. Instead, there are a number of existing Government schemes that provide assistance in helping to reduce heating bills, including those to improve the energy efficiency of homes. For example, our Warm Home Discount is providing a £140 discount this winter off the electricity bills of 2 million low income and vulnerable households in England, Scotland and Wales.
13. In addition, the Scotland Bill will devolve further powers to Scottish Ministers to design energy supplier obligations and fuel poverty reduction schemes in Scotland. This will allow

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<sup>6</sup> RIIO (Revenue = Incentives + Innovation + Outputs) is Ofgem's new approach to setting network regulatory controls. For electricity distribution, it was first implemented from April 2015.

<sup>7</sup> *Regional differences in network charges* (Ofgem, October 2015)



Scottish Ministers to target schemes in a way that best suits Scottish needs, within a fair proportion of the overall GB-wide schemes.

## 3.2. Support for consumers in the North of Scotland

14. There are three measures which provide support specifically to groups of electricity consumers in the North of Scotland: the Hydro Benefit Replacement Scheme; the Common Tariff Obligation; and the Shetland cross-subsidy. Details of each measure are set out in the following sections.

## 3.3. Hydro Benefit Replacement Scheme

### What is the Hydro Benefit Replacement Scheme?

15. The Energy Act 2004 (Assistance for Areas with High Distribution Costs) Order 2005 requires authorised transmitters (National Grid as transmission system operator for Great Britain) to make a payment to the relevant distributor (SHEPD) serving a single specified area (North of Scotland), where distribution costs are significantly higher than elsewhere in Great Britain. This is done through the Hydro Benefit Replacement Scheme. This 'assistance amount' is recovered through charges on licensed electricity supply companies across Great Britain and passed on to the relevant distribution company to reduce distribution costs in that area.
16. The aim of the scheme is to protect consumers in the North of Scotland from the very high electricity distribution charges that would otherwise arise. Without the benefit of the scheme, consumers in the North of Scotland would face significantly higher distribution charges than any other GB region.

### History of the Hydro Benefit Replacement Scheme

17. The original rationale for Hydro Benefit was that the costs of providing power to remote Highlands and Island consumers was high, mainly due to the harsh and remote terrain which added significantly to maintenance costs. SSE was vested with a large number of small hydro stations and dams in the north west of Scotland linked to lochs. Many of these were built in the first half of the 20th Century at high public cost. The fuel (rain fall and snow melt) was effectively free and plant maintenance was generally low. Therefore Hydro Benefit was set up to make sure that some benefit of this cheap form of electricity was passed to remote consumers.
18. Hydro Benefit came about in the 1940s and was formalised on the privatisation of the Scottish electricity industry in the 1990s through specific licence conditions. The licence conditions required Scottish and Southern Electricity's (SSE) generation business to pay an amount of money to SSE's network businesses and that this money would be used to offset distribution and/or transmission charges for consumers in the Highlands and Islands. The amount to offset transmission charging was set to zero but the amount set to offset distribution charges was set at £40m per annum. Hydro Benefit was unique in that Northern Scotland was the only area where cross subsidy of this sort was explicitly allowed.
19. The original scheme was abolished in January 2004. A new scheme was created to replace it, whereby the high costs of electricity distribution to consumers in the North of Scotland was spread across Great Britain. The new scheme commenced on 1 April 2005 under the power in section 184 of the Energy Act 2004. The subsidy is funded by charges on licensed suppliers across Great Britain.

## How does the Hydro Benefit Replacement Scheme work?

20. Section 184 of the Energy Act 2004 gives the Secretary of State the power to require authorised transmitters to make a payment to the relevant distributor serving a single specified area, where distribution costs are significantly higher than in any other area of Great Britain. The payment must be passed from the distributor to authorised suppliers within the area, through reduced use of system charges. The scheme must be funded by charges on licensed suppliers across Great Britain.
21. The Order stipulates:
- (i) That the area covered is the North of Scotland Specified Area<sup>8</sup>, previously defined in connection with the Electricity Act 1989.
  - (ii) A level of payment that is the same as the level of payment when the previous scheme was withdrawn.
22. The Hydro Benefit Replacement Scheme is administered by National Grid as transmission system operator. National Grid has a licence condition that obliges it to collect the 'assistance amount' from licensed suppliers across Great Britain and pass it on to the relevant distributor for the North of Scotland to reduce distribution costs in that geographic area.
23. The 'assistance amount' is recovered from licensed suppliers based on the total amount of electricity they supply to their customers. Consequently the 'Big Six' suppliers contribute around 84%<sup>9</sup> of the total assistance amount, with other licensed suppliers contributing the remainder.

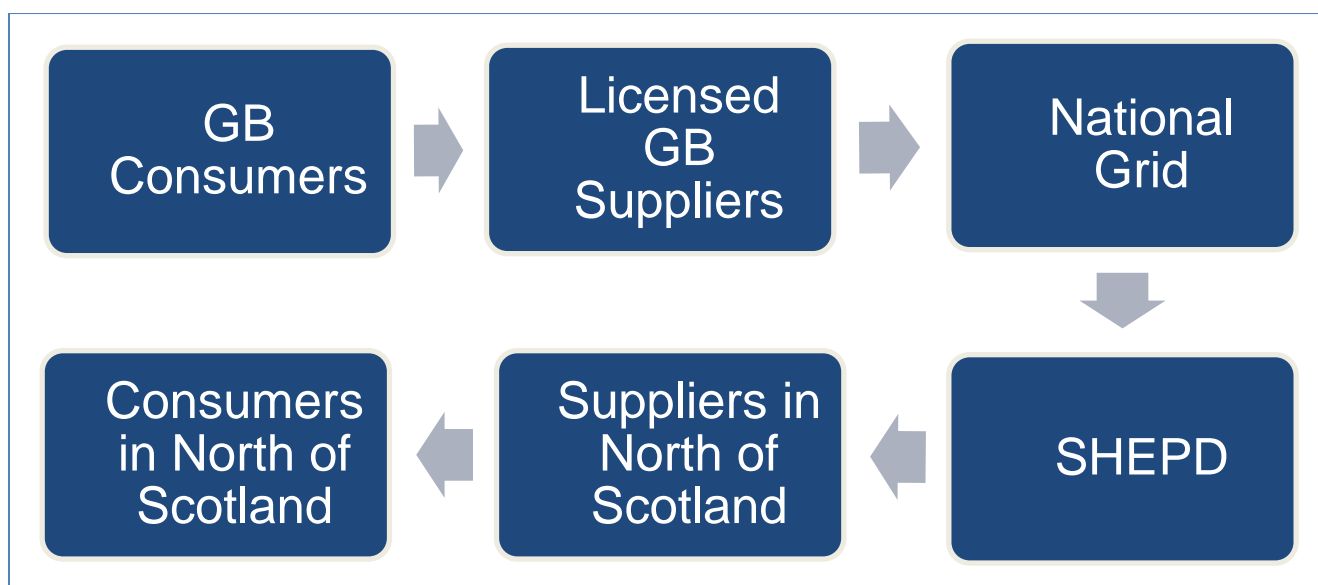


Figure 1: Flow of assistance provided by the Hydro Benefit Replacement Scheme

<sup>8</sup> A description of the area covered by the scheme is set out at Schedule 2 of the *Electricity Act 1989 (Uniform Prices in the North of Scotland) Order 2005*.

<sup>9</sup> Source: National Grid

### What does the Hydro Benefit Replacement Scheme cost?

24. In 2015/16 the assistance amount totals some £57.5m which includes a small payment to National Grid to cover the costs of administering the scheme<sup>10</sup>. This assistance equates to an average bill reduction of around £41<sup>11</sup> a year to the 680,000 domestic consumers in the North of Scotland, with the remainder of the assistance enabling bill savings for the 75,000 non-domestic consumers in this region. The average cost of this assistance for each GB domestic consumer is less than £1 per year.

## 3.4. Common Tariff Obligation

### What is the Common Tariff Obligation?

25. The Common Tariff Obligation implements the Government policy ensuring that comparable domestic customers in the peripheral areas of the North of Scotland are not charged different prices purely on the basis of where they live. This policy is intended to avoid the socially undesirable consequences that may otherwise occur.
26. The Common Tariff Obligation prohibits suppliers from charging comparable consumers different prices on the basis of their location in the North of Scotland. It only covers domestic customers, not non-domestic consumers. Suppliers can offer different terms to customers, provided they ensure that these differences are not determined on the basis of the customers' geographical location within the North of Scotland.

### History of the Common Tariff Obligation

27. The Common Tariff Obligation was originally set out in section 3(2)(a) of the Electricity Act 1989. A duty was imposed on the Secretary of State and the Regulator to ensure that electricity suppliers maintained a common tariff within a given area of Scotland. In 1990 the Secretary of State laid an Order under the Electricity Act 1989 which specified the area the Common Tariff Obligation would be applied to as 'North Scotland' (this is the same area as that covered by the Hydro Benefit Replacement Scheme).
28. The Utilities Act 2000 (c.27) repealed section 3(2)(a) of the Electricity Act 1989 and inserted Section 7B. This enabled the Secretary of State to lay an Order requiring transmission, distribution and supply licensees to charge prices, or offer contractual terms (suppliers) that do not distinguish between users in different parts of North Scotland. However, no Order was made under this section for nearly five years.
29. The market nonetheless continued to operate on the assumption that the Order under section 3(2)(a) of the Electricity Act 1989 continued in effect (probably because Standard Licence Condition 42 referred to the Common Tariff Obligation as if the Order were in effect). The omission was however rectified when an Order was made on 1 April 2005 to ensure that customers in North Scotland continued to be charged prices that do not differentiate according to geographical location.

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<sup>10</sup> For 2015/16, the payment to National Grid to cover the costs of administering the scheme is £106,665.

<sup>11</sup> SHEPD's Common Distribution Charging Methodology Model was used to calculate the average bill reduction of £41. The model was run twice, once with the £57.5m assistance amount included and once without. The different runs produced different tariffs for domestic consumers. Average bill calculations were calculated for both with and without the assistance amount, with the difference between the bill calculations being £41.

### How does the Common Tariff Obligation work?

30. The Common Tariff Obligation Order simply provides that holders of supply, distribution or transmission licences shall ensure that the prices/charges payable for the purpose of supplying any domestic premises in the North of Scotland “do not take into account the geographical location within that area”.
31. The Common Tariff Obligation is monitored and enforced by Ofgem through its licensing system. Ofgem has powers to impose fines on businesses which do not comply with their licence obligations and ultimately to revoke licences.

### 3.5. Shetland cross-subsidy

#### What is the Shetland cross-subsidy?

32. Shetland is isolated from the GB mainland with, currently, no electricity link or natural gas network. It has the only licensed distribution network that is not connected to the wider GB electricity network, which puts it in a unique position. Local generation is required to meet all electricity demand, which leads to high average costs of electricity supply. This means there is good justification for providing support to Shetland consumers.
33. Consumers on Shetland benefit from a cross-subsidy arrangement which prevents the distinction of electricity supply prices across the North of Scotland on the basis of location. The resulting costs are currently spread across all consumers in the SHEPD area covering the North of Scotland.
34. The cross-subsidy arrangement for domestic consumers on Shetland is underpinned by the Common Tariff Obligation, and Government recently put in place a Secretary of State direction to enable continuation of this arrangement for existing non-domestic consumers from April 2015 onwards. At the same time, Government enabled the cross-subsidy to apply to future non-domestic connections on Shetland with a maximum demand capacity of 2MVA at any one site.

#### How much does the Shetland cross-subsidy currently cost and how is it calculated?

35. As noted above, the electricity cross-subsidy arrangement for all consumers on Shetland amounted to £28.5m in 2014/15<sup>12</sup>. Without this subsidy, the price of electricity on Shetland would be around 75% higher than the price of that on the mainland. The cross-subsidy arrangement brings prices on Shetland into line with those in the North of Scotland.
36. SHEPD's Licence Condition sets out a formula for calculating the level of subsidy, which is based on the overall costs of the electricity system for Shetland minus income received from suppliers. An efficiency incentive is applied to those elements under SHEPD's direct control<sup>13</sup>. SHEPD reports the value of the subsidy annually to Ofgem. The reported values are subject to an independent audit check and review by Ofgem.

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<sup>12</sup> Source: Ofgem

<sup>13</sup> Further information on calculation of the subsidy is contained in Appendix 7 of *RIIO-ED1: Final determinations for the slow-track electricity distribution companies* (Ofgem, November 2014).

### Spreading the costs of the Shetland cross-subsidy

37. The costs of this cross-subsidy are uncertain from around 2019 onwards due to the need for a new energy solution for Shetland to maintain security of supply. Whilst Ofgem is working with SHEPD to minimise cost implications, there are concerns that the expected increase could result in a level of cross-subsidy for Shetland that would place too great a burden on consumers in the North of Scotland, if the existing cost-recovery arrangement was continued.
38. In light of this, Government confirmed its intention to introduce a cross-GB cost recovery mechanism once the new energy solution for Shetland is implemented. The effect of this will be to reduce costs for all consumers in the North of Scotland. It was also confirmed that the specific delivery mechanism for this measure would be considered as part of the 2015/16 review of the Hydro Benefit Replacement Scheme and the Common Tariff Obligation.

## 4. The Government's position

### 4.1. Rationale

39. As noted in the preceding section, there are advantages to a charging system which broadly reflects the costs that different users place on the system. Most importantly, it encourages an efficient system where overall network costs are minimised for consumers across GB. For example, electricity distribution charges have fallen over the last year by an average of £11 per household for GB as a whole, with an even larger decrease seen in the North of Scotland. Hence the Government believes that, in general, cost reflective charging continues to represent the right approach. However, it is right that Government should consider intervention if one region has markedly different charging levels to any other. Indeed, this forms the rationale for introducing the Hydro Benefit Replacement Scheme and reviewing whether the level of support remains appropriate.
40. When the Hydro Benefit Replacement Scheme came into force in April 2005 with the switch to the British Electricity Transmission Trading Arrangements, the cost of distributing electricity in the North of Scotland was assessed as being about 50% higher than elsewhere in Great Britain. This was mainly due to the cost of maintaining the distribution network over long distances and in sparsely populated terrain. Recent analysis<sup>14</sup> undertaken by Ofgem shows that the cost of distributing electricity in the North of Scotland remains significantly higher than other regions, but that the Hydro Benefit Replacement Scheme ensures this does not result in significantly higher distribution charges. Indeed, when electricity transmission is also taken into account, total electricity network charges for the North of Scotland are similar to two other regions.
41. Whilst the Hydro Benefit Replacement Scheme protects consumers as a whole across the North of Scotland, it should be noted that it does not (and never could) provide an efficient or effective way of providing targeted support to a specific group of vulnerable consumers within a region. Instead, existing Government schemes provide assistance in helping to reduce heating bills, including those to improve the energy efficiency of homes.
42. The costs of supplying electricity to remote areas of the North of Scotland will inevitably remain higher than to urban areas. The Common Tariff Obligation continues to fulfil the social objective of ensuring that remote, rural consumers are not disadvantaged by price discrimination within the North of Scotland.
43. The Government therefore believes that the original policy objectives of both schemes remain relevant, both continue to meet those objectives and the current assistance amount provided by the Hydro Benefit Replacement Scheme is appropriate. Hence the Government is minded to retain these schemes in their current form at this time. In relation to the Budget announcement made in March 2015, the Government is minded not to reduce electricity distribution charges in the North of Scotland beyond the current level of support as it would result in lower total electricity network charges than at least two other GB regions. Additionally, it would represent a further move away from cost reflective charging, which helps to minimise overall network costs.

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<sup>14</sup> *Regional differences in network charges* (Ofgem, October 2015)

### Consultation Question

- |    |   |
|----|---|
| 1. | Do you agree that the policy objectives of the Hydro Benefit Replacement Scheme and Common Tariff Obligation – which are focused on ensuring that consumers in the North of Scotland do not bear an unreasonable burden of electricity distribution costs – remain valid? |
|----|---|

### Consultation Question

- |    |   |
|----|---|
| 2. | Do you agree that the assistance amount provided by the Hydro Benefit Replacement Scheme is appropriate, when overall electricity network charges are considered, or should it be either decreased or increased? Please give reasons and provide evidence to support your answer. |
|----|---|

## 4.2. Operation of the Hydro Benefit Replacement Scheme and Common Tariff Obligation

44. In establishing the Hydro Benefit Replacement Scheme, the Government sought to ensure that the scheme's administration would be cost efficient and that its operation would be clear and unambiguous for all parties. The Government considers that these requirements continue to be met through the existing arrangements. Administration is provided through a small, fixed, RPI-linked fee which represents less than 0.2% of the total value of the subsidy. In order to ensure transparency of the scheme's operation, National Grid is required to publish an annual statement<sup>15</sup> which states the total actual metered demand in the previous year, the total amount that was actually invoiced to suppliers, any over- or under-recovery, the value of the RPI used in determining the payment in the following year and the total level of the payment that will be required in the following year.
45. The Hydro Benefit Replacement Scheme was established without a licence obligation on suppliers to pass on the savings to end-consumers. The rationale for this was that the competitive market for electricity supply in the North of Scotland would be sufficient to ensure that any savings would feed through to consumers. The Government has seen no evidence to suggest that such a licence obligation would now be needed, but would welcome views from any interested parties.
46. The Common Tariff Obligation is a self-sufficient scheme which has no direct costs associated with it. The Government therefore does not see any way to improve its implementation.

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<sup>15</sup> Available at: <http://www2.nationalgrid.com/UK/Industry-information/System-charges/Electricity-transmission/Assistance-for-areas-with-high-distribution-costs/>

### Consultation Question

- |    |   |
|----|---|
| 3. | Do you agree that the Hydro Benefit Replacement Scheme and Common Tariff Obligation remain operationally effective? |
|----|---|

### Consultation Question

- |    |  |
|----|--|
| 4. | Do you have any evidence to show that the savings resulting from the Hydro Benefit Replacement Scheme are not being passed on fully by suppliers to end-consumers? If so, would the introduction of a licence obligation on suppliers to pass on the savings be an effective way of addressing this? |
|----|--|

## 4.3. Delivery of the Shetland cross-subsidy

47. The Government believes that cross-GB cost recovery of the Shetland subsidy would be best delivered through the existing Hydro Benefit Replacement Scheme, as this should provide an efficient and transparent approach. This change would take effect from the point at which the new energy solution for Shetland is implemented, which is currently expected to be around 2019.
48. As now, SHEPD would be responsible for calculating the value of the Shetland cross-subsidy on an annual basis and Ofgem would oversee arrangements for the verification of this amount. The Order which governs the Hydro Benefit Replacement Scheme would be amended to include a second formula, which would specify how the Shetland cross-subsidy is to be calculated. In addition, the amended Order would set out the timescales by which SHEPD must provide relevant information to National Grid to inform the level of cross-subsidy.
49. National Grid's obligations under the Order would be extended to include:
- calculating a p/kWh tariff to cover the total cost of the Shetland cross-subsidy each year, and including this sum as part of the invoices which are issued to licensed suppliers under the Scheme. Payment terms would be the same as currently apply for the Scheme;
  - detailing in its annual Scheme statement the p/kWh tariff that will apply for the Shetland cross-subsidy;
  - passing the sums collected from licensed suppliers to SHEPD, as the electricity distributor for the North of Scotland, who would apply the benefit of this payment to reduce the use of system charges to suppliers in the North of Scotland in a non-discriminatory way.
50. The Order would place equivalent requirements on licensed suppliers to pay to National Grid the p/kWh tariff for the Shetland cross-subsidy, and on SHEPD to pass sums received from National Grid to licensed suppliers in the North of Scotland.
51. For the avoidance of doubt, the existing assistance amount provided under the Hydro Benefit Replacement Scheme (i.e. £57m in 2015/16) will continue, with an additional sum relating to the Shetland cross-subsidy also collected through the scheme from the point at which the new energy solution for Shetland is implemented.



52. National Grid's new obligations in relation to the Shetland cross-subsidy would largely overlap with tasks already undertaken for the existing Scheme. Hence the Government believes that the allowance which National Grid currently receives to cover its costs for administering the scheme should not be increased in light of the Shetland cross-subsidy.

#### Consultation Question

5.	Do you agree that the Hydro Benefit Replacement Scheme provides the best way of delivering revised funding arrangements for the Shetland cross-subsidy? If not, what alternative mechanism(s) could be used?
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#### Consultation Question

6.	Do you agree that the specific arrangements proposed in this consultation document for delivery of the revised funding arrangements for the Shetland cross-subsidy through the Hydro Benefit Replacement Scheme are effective? If not, what changes or additions should be made?
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## 4.4. Conclusion

53. The Government has reviewed the policy objectives and design of the Hydro Benefit Replacement Scheme and the Common Tariff Obligation, and the level of electricity distribution and transmission charges relating to consumers in the North of Scotland. The Government remains committed to protecting consumers in the North of Scotland from the full impact of high electricity network costs, and considers that the schemes are effective in achieving this.
54. Aside from providing for the future cross-GB cost recovery of the Shetland subsidy through the Hydro Benefit Replacement Scheme, the Government is minded to not make any changes to the Orders governing both the Hydro Benefit Replacement Scheme and Common Tariff Obligation at this time, but welcomes responses from any interested parties to the consultation questions. There is no sunset clause included in either scheme, so both continue to operate whilst the review is carried out.

## 5. Catalogue of consultation questions

### Consultation Question

1. Do you agree that the policy objectives of the Hydro Benefit Replacement Scheme and Common Tariff Obligation – which are focused on ensuring that consumers in the North of Scotland do not bear an unreasonable burden of electricity distribution costs – remain valid?

### Consultation Question

2. Do you agree that the assistance amount provided by the Hydro Benefit Replacement Scheme is appropriate, when overall electricity network charges are considered, or should it be either decreased or increased? Please give reasons and provide evidence to support your answer.

### Consultation Question

3. Do you agree that the Hydro Benefit Replacement Scheme and Common Tariff Obligation remain operationally effective?

### Consultation Question

4. Do you have any evidence to show that the savings resulting from the Hydro Benefit Replacement Scheme are not being passed on fully by suppliers to end-consumers? If so, would the introduction of a licence obligation on suppliers to pass on the savings be an effective way of addressing this?

### Consultation Question

5. Do you agree that the Hydro Benefit Replacement Scheme provides the most appropriate way to deliver revised funding arrangements for the Shetland cross-subsidy?

### Consultation Question

6. Do you agree that the specific arrangements proposed in this consultation document for delivery of the revised funding arrangements for the Shetland cross-subsidy through the Hydro Benefit Replacement Scheme are effective? If not, what changes or additions should be made?

## Annex: Electricity network charges by region

On 23<sup>rd</sup> October 2015, Ofgem published an analysis of regional differences for households in network charges<sup>16</sup>. The following table is drawn from that analysis. It shows that electricity distribution charges are higher than average in the North of Scotland, Merseyside & North Wales and South West England, and lower in London and Eastern England. In contrast, electricity transmission charges for demand are higher in the South of England and lower in Scotland. When total transmission and distribution charges for demand are taken into account, North of Scotland households have similar charging levels to Merseyside & North Wales and South West England.

This analysis includes the positive impact of the Hydro Benefit Replacement Scheme in reducing electricity distribution charges in the North of Scotland. Without the scheme, the North of Scotland would have significantly higher charges than any other region.

Ofgem's analysis is based on the 2015-16 charging statements produced by network companies. It assumes that electricity consumption is 3,100 kWh for single rate households and 4,300 kWh for Economy 7 households.

(£/household/y)	North Scotland	South Scotland	North East England	North West	Yorkshire	Merseyside/ N Wales	East Midlands	West Midlands	Eastern England	South Wales	Southern England	London	South East England	South West England
<b>Typical single rate consumption (3100 kWh/y)</b>														
Transmission charges	21	21	26	30	32	34	32	33	34	32	37	37	35	35
Distribution charges	122	95	87	84	77	116	76	80	76	96	80	66	86	107
Total transmission and distribution charges	143	116	113	114	109	150	108	113	110	128	117	103	121	142
<b>Typical Economy 7 consumption (4300 kWh/y)</b>														
Transmission charges	29	30	36	42	45	48	44	46	47	45	51	51	49	49
Distribution charges	134	95	88	75	78	118	79	77	77	92	74	67	91	106
Total transmission and distribution charges	163	125	124	117	123	166	123	123	124	137	125	118	140	155

<sup>16</sup> *Regional differences in network charges* (Ofgem, October 2015)

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