



Department  
of Energy &  
Climate Change

# Support for Non-Domestic Electricity Consumers on Shetland

Government Response to the 24 July 2014  
Consultation

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Any enquiries regarding this publication should be sent to us at

Future Electricity Networks  
Department of Energy & Climate Change,  
3 Whitehall Place,  
London,  
SW1A 2AW

Tel: 0300 068 5827

Email: [shetlandsubsidy@decc.gsi.gov.uk](mailto:shetlandsubsidy@decc.gsi.gov.uk)

The consultation and Impact Assessment can be found on DECC's website:

<https://www.gov.uk/government/consultations/support-for-non-domestic-electricity-consumers-on-shetland>

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# Executive Summary

## Overview

1. The isolated nature of Shetland's electricity infrastructure means that the costs of electricity supply there are significantly higher than in the rest of GB. A cross-subsidy prevents the distinction of electricity supply prices across northern Scotland to protect consumers in Shetland from the high costs they would face otherwise.
2. On 24<sup>th</sup> July 2014 DECC published a consultation proposing to continue support for non-domestic electricity consumers on Shetland (domestic consumers are protected by the Common Tariff Obligation). Without Government action, the cross-subsidy for this group would lapse at the end of March 2015. The consultation proposed that continued support would be subject to the introduction of a limit on the capacity of connection which would be eligible. In addition, the consultation also considered the impact of the introduction of a new integrated energy solution for Shetland expected in around 2019. Due to the likely scale of the required expenditure, it was proposed that from this point the basis of the cross-subsidy would change to spread the costs over Great Britain rather than just across the North of Scotland.
3. Twelve respondents replied to the consultation – ten of whom are based in Scotland. The responses were from energy companies, non-domestic consumers on Shetland, other utilities, local authority bodies and a registered charity representing both Scotland and the wider UK. DECC would like to thank all respondents who submitted a formal response. A list of respondents is at Annex A.
4. The responses suggested widespread support for the cross-subsidy. However, many questioned the proposal to introduce a 2MW capacity limit for new non-domestic consumers to receive the cross-subsidy and sought clarification on how the limit would apply to existing non-domestic consumers on Shetland.

5. DECC has updated the associated Impact Assessment and remains of the view that the cross-subsidy for non-domestic consumers on Shetland should not be allowed to lapse at the end of March 2015 and that the cost of the cross-subsidy should be limited by the introduction of a 2MW capacity. DECC recognises the need to clarify how the 2MW limit would apply to existing non-domestic consumers on Shetland. **DECC therefore confirms its intention to implement the proposed policy to continue the cross-subsidy for existing non-domestic consumers and introduce a 2MW capacity limit for new non-domestic consumers.**
6. There was also general support for introducing a cross-GB basis for spreading the costs of the cross subsidy once a new integrated energy solution for Shetland has been implemented. **DECC therefore also confirms its intention to introduce a cross-GB cost recovery mechanism which will be considered as part of the consultation on increasing the level of support provided through the Hydro Benefit Replacement Scheme that was announced in the Budget Statement on 18 March 2015.**

## Key Policy Decisions

7. DECC will continue to enable the cross-subsidy for all existing non-domestic connections on Shetland regardless of their existing or future demand connection capacity at any one site. DECC will also enable the cross-subsidy to apply to future non-domestic connections on Shetland with a maximum demand capacity of 2MW at any one site. Costs will continue to be recovered under these arrangements from all Scottish Hydro Electric Power Distribution (SHEPD) electricity consumers until a new integrated energy solution for Shetland has been implemented.
8. An existing non-domestic connection on Shetland is a connection for a supply of electricity to non-domestic premises under a connection agreement made before the Direction comes into effect.

## Background

9. Domestic and non-domestic consumers on Shetland currently benefit from a cross-subsidy arrangement which prevents the distinction of electricity supply prices across northern Scotland on the basis of location. DECC's policy intent is to protect consumers in Shetland from the high costs they would otherwise face due to the isolated nature of the electricity network. As Shetland has the only licensed distribution network that is not

connected to the wider GB electricity network, the provision of support does not set a precedent for similar support to other areas in the UK.

10. Through a review of the Common Tariff Obligation in 2013, DECC confirmed that domestic consumers should continue to be protected. This consultation process does not impact the outcome of that review.
11. This consultation sought views on a proposed policy of continuing the cross-subsidy for all existing non-domestic electricity consumers on Shetland. DECC also consulted on the cross-subsidy supporting future non-domestic consumers with a maximum demand connection of 2MW.
12. In addition, DECC understands that replacement of the ageing Lerwick Power Station will soon be required. This is the main source of generation on Shetland and is crucial to maintain security of supply. Whilst Ofgem is working with SHEPD to minimise the cost implications of this, it is probable that there will be a further increase in the cost of supplying electricity on Shetland once the integrated energy solution is implemented around 2019. There are concerns that these further cost increases could result in a level of cross-subsidy for Shetland that would place too great a burden on northern Scotland consumers if costs were to be recovered only from them. In light of this, DECC consulted on a proposal to recover costs from all GB electricity consumers once a new integrated energy solution for Shetland has been implemented.
13. The Impact Assessment published with the consultation document considered three scenarios including a proposed preferred policy option and assessed the costs and benefits of the proposed policy.

## Next Steps

14. DECC intends to implement its decision through a direction by the Secretary of State to SHEPD setting out the treatment of non-domestic connections on Shetland in SHEPD's licence. The intent of this direction will be implemented through the Special Licence Condition.

# Detailed Analysis of Consultation Responses and the Government's Response

## Non-Domestic Consumers to Benefit from the Shetland Cross-Subsidy

Consultation Questions		
1.	<b>Do you agree that all existing non-domestic demand consumers on Shetland should continue to receive the cross-subsidy? If not, do you have reasons why all existing non-domestic consumers should not continue to receive the cross-subsidy?</b>	
<b>Yes: 9</b>	<b>No: 0</b>	<b>No response: 3</b>

15. All responses to this question either explicitly supported continuation of the cross-subsidy for existing non-domestic connections on Shetland or implicitly supported its continuation whilst focussing on the 2MW limit. No responses explicitly opposed continuation of the cross subsidy.

16. It was noted that removal of the cross-subsidy would place additional costs on businesses located on Shetland which could adversely affect their ability to compete with their equivalents on the mainland. In addition it was suggested that higher electricity costs would place an additional financial burden on essential public services including schools and hospitals. **Therefore the Secretary of State will direct SHEPD to continue the cross-subsidy for existing non-domestic connections under their current conditions.**

Consultation Questions	
2.	<b>Should a capacity limit be applied to future non-domestic consumers able to receive the cross-subsidy?</b>

Yes: 2	No: 8	No response: 2
3.	<p><b>If a capacity limit is applied to future non-domestic consumers, do you agree this should be set at a maximum demand connection agreement of 2MW? If not, what alternative level for a maximum demand connection agreement would you suggest? And for what reasons?</b></p>	
Yes: 2	No: 8	No response: 2

17. Whilst recognising concerns over the potential future cost of the subsidy, most responses did not support application of a capacity limit on future non-domestic connections to benefit from the cross-subsidy. Some responses questioned the need for a limit at all, whilst others questioned why, if there was to be one, it should be set at 2MW. Several responses focussed on how the 2MW limit would apply to existing non-domestic connections who would want to expand a demand connection beyond the limit in the future.

18. One respondent pointed out that almost half of homes in the SHEPD area are off the mains gas network and a significant minority are also off the electricity distribution system. The area contains a high number of 'hard to treat' low thermal efficiency properties and the population earns less than 75% of the UK average per household income. All of these factors lead to a disproportionate level of fuel poverty in the Highlands and Islands and the current approach to supporting the additional costs of electricity production in Shetland exacerbates an already sensitive affordability scenario.

19. DECC intends to limit the cost burden on consumers in northern Scotland that arises from supporting this cross-subsidy by introducing a capacity limit for receipt of the cross-subsidy for future non-domestic connections on Shetland. However DECC does not seek to limit the expansion of demand by existing non-domestic consumers so as to ensure that existing business users are not disadvantaged. Therefore this limit will not affect the arrangements for existing non-domestic connections.

20. The value of the cross-subsidy to be recovered has risen each year and will impact fuel poverty levels in northern Scotland. One response from a Scottish utility company supported the introduction of a capacity limit stating it "seems a fair and equitable way of

sharing out the non-domestic demand.” DECC has therefore concluded that there is a need to limit the extent to which the cost of providing the Shetland cross-subsidy increases in the future, especially in the light of the expected cost of replacement of Lerwick power station.

21. One respondent suggested a metered cross-subsidy based upon actual energy use as an alternative to a capacity limit. Whilst this could be argued to offer a more accurate method to implement the capacity limit, DECC does not view this as a practical solution. A capacity limit provides clarity, ease of implementation, minimal introduction costs and ease of use in comparison to a metered approach.

**22. Based upon the evidence presented, DECC will implement the proposed policy and introduce a capacity limit for future non-domestic connections on Shetland to receive the cross-subsidy.**

23. DECC believes the 2MW capacity limit will incentivise energy saving behaviours by customers requiring new large non-domestic connections on Shetland. This would be good for sustainability on Shetland as well as reducing the electricity supply costs there. One respondent referenced the Faroe Islands as demonstrating the benefits of such energy saving behaviours observing that the “Faroe Islands have had success with this by directly managing the loads at fish factories to lessen the requirements for extra diesel generation. This is done by temporarily turning off non-essential loads and also allowing loads to be turned on to maintain renewable generation in cases of overabundance of renewables”. DECC would like to see the results of the Faroese investigation used to produce innovative solutions in Shetland along with proposals to reduce costs in the full energy solution.

24. The impact of the cross-subsidy on GB consumers once the integrated energy solution has been delivered around 2019 should be mitigated by reducing the cost of generation on Shetland where possible, more effective grid management and load control and maximising the use of renewable energy. This has been investigated to some extent in the NINES<sup>1</sup> pilot project. DECC encourages the development and implementation of the ideas the project identified. The use of heating loads across Shetland, and the ability to

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<sup>1</sup> Northern Isles New Energy Solutions (NINES) aims to deliver a secure, affordable and reliable energy system for Shetland.

manage large consumer loads such as in the fish processing plants could help reduce costs of generation along with more efficient plant and more renewable energy.

25. In the interests of clarity for non-domestic consumers, the following table sets out how the capacity limit will apply.

Type of Non Domestic Connection	Approach
Existing connection 2MW or under	Covered by cross subsidy
Existing connection 2MW or under expanding to over 2MW	Covered by cross subsidy
Existing connection over 2MW	Covered by cross subsidy
Existing connection over 2MW seeking further expansion at the same premises	Covered by cross subsidy
Future connection 2MW or under	Covered by cross subsidy
Future connection 2MW or under that subsequently expands to over 2MW at the same premises	Not covered by cross subsidy
Future connection over 2MW	Not covered by cross subsidy

26. DECC considers that a capacity limit of 2MW for new non-domestic connections is an appropriate threshold that strikes the right balance between allowing new businesses of a similar size to existing non-domestic consumers to be established on Shetland, whilst limiting the cost of the cross subsidy for consumers across the SHEPD area. It does not restrict the growth of existing businesses and will encourage the establishment of SMEs on Shetland.

27. The details of the method of implementation of the cross-subsidy will continue and the introduction of the capacity limit will be developed by SHEPD and regulated by Ofgem.

**28. Therefore, on the evidence available to DECC, the introduction of a 2MW capacity limit for future non-domestic connections on Shetland is appropriate. DECC will work with Ofgem and SHEPD to implement this capacity limit for new non-domestic connections.**

## Shetland Cross-Subsidy Cost Recovery

Consultation Questions		
4.	<p><b>Do you agree that a “Two Stage” approach is preferable because it enables the long-term arrangements to be finalised while ensuring continuity in the current subsidy arrangements?</b></p>	
<b>Yes: 6</b>	<b>No: 1</b>	<b>No response: 5</b>

Consultation Questions		
5.	<p><b>Do you agree that, under the proposed “Two Stage” approach to cost recovery, once the costs for a full energy solution for Shetland take effect, the cross-subsidy costs should be socialised across all GB consumers?</b></p>	
<b>Yes: 5</b>	<b>No: 1</b>	<b>No response: 6</b>

29. The current cross-subsidy is recovered across SHEPD’s northern Scotland consumers. DECC’s consultation proposed spreading of these costs across all GB consumers from around 2019 once the costs resulting from the integrated energy solution for Shetland take effect.
30. DECC’s policy intent is to offer support and certainty to the fuel poor in northern Scotland and to businesses on Shetland in light of increasing electricity supply costs. In support of this, DECC believes that the potential increase in costs arising from the integrated energy solution will justify these costs being spread across all GB consumers. This approach was supported by the majority of responses
31. One respondent stated that it welcomed the move to socialise the electricity charges for Shetland across GB as it would provide a broader base for the subsidy to be recovered and help to reduce energy cost disparity between regions. It would also recognise the impact that the higher cost of energy faced by consumers across the north of Scotland has on fuel poverty.

32. SHEPD also stated its support for socialising costs across GB by stating “SHEPD welcomes and agrees with DECC’s proposal that the cross-subsidy will shortly be recovered from all GB consumers, which in our view is the most equitable approach to tackling the higher generation and balancing costs on Shetland.”
33. One potential way to deliver this would be for DECC to introduce a mechanism similar to that used for the Hydro Benefit Replacement Scheme which is recovered by National Grid through Transmission Network Use of System (TNUoS) charges. National Grid confirmed that it would work with DECC, Ofgem and SHEPD to implement a suitable method for recovering the cross-subsidy costs. National Grid’s previous experience of such cost recovery mechanisms suggests customers value their predictability and transparency.
34. One respondent argued that recovering the cross-subsidy costs through general taxation would be more appropriate than through a network charging system such as TNUoS. DECC considers that lower administrative costs can be expected through using a cross-subsidy mechanism.
35. **Therefore DECC will implement a “two stage” approach, with the costs of the cross-subsidy being met by consumers across the North of Scotland until the new integrated power solution for Shetland is implemented at which stage the cross-subsidy costs will be spread across all GB electricity consumers. This will be considered as part of the consultation on increasing the level of support provided through the Hydro Benefit Replacement Scheme that was announced in the Budget Statement on 18 March 2015.**

Consultation Questions		
6.	<p><b>Should the potential impact on small businesses across GB from socialising the cross-subsidy be mitigated in some way? If so, how might this be done?</b></p>	
Yes: 2	No: 3	No response: 7

36. DECC received five responses to this question. No specific detail was given on the potential impacts the costs may have on small and micro businesses with three responses stating the costs were expected to be low and that either no mitigation was needed or it was up to the Government to decide what, if any, mitigation was appropriate.

37. DECC considers that the cross-subsidy would have only a marginal cost impact on small and micro non-domestic consumers in GB from 2019 onwards.

**38. Therefore DECC will not provide any mitigation against the potential impact on small and micro businesses due to the low cost impact expected for such businesses.**

## Review Period

Consultation Questions		
7.	Do you agree with DECC's proposed review period?	
Yes: 4	No: 1	No response: 7

39. The majority of responses supported the proposal to review the cross-subsidy arrangements in 2023 to coincide with Ofgem's next electricity distribution price control review. This would be some years after the implementation of the cross-GB subsidy mechanism. Any substantial change in relevant circumstances with a potential to impact on the electricity supply arrangements on Shetland would be a key consideration during any review. We would not expect to re-evaluate the arrangements ahead of that price control review unless there was a material change to the circumstances relating to the energy supply arrangement on Shetland.

**40. Therefore DECC will implement the proposed review period.**

# Next Steps

## Implementation

41. The Secretary of State will issue a Direction (Annex B), to SHEPD to implement the policy set out in this Government response in relation to the operation of the Shetland non-domestic electricity cross-subsidy.
42. Ofgem will introduce licence conditions for SHEPD setting out the detailed implementation of the non-domestic cross subsidy. Ofgem is also responsible for ensuring SHEPD delivers against its licence conditions.
43. DECC welcomes SHEPD's response which stated "SHEPD proposes joint working with DECC to identify and discuss proposals which could facilitate charging of unsubsidised electricity costs for relevant consumers".
44. DECC will consider the best legislative approach for delivering the cross-GB subsidy for introduction once the new integrated energy solution for Shetland has been implemented. **This will be considered as part of the consultation on increasing the level of support provided through the Hydro Benefit Replacement Scheme that was announced in the Budget Statement on 18 March 2015.**

## Respondents

<b>Respondents</b>	
1	Scottish Hydro Electric Power Distribution (SHEPD)
2	Scottish and Southern Energy (SSE)
3	Highlands and Islands Enterprise (HIE)
4	EDF Energy
5	Citizens Advice Scotland
6	Shetland Islands Council
7	National Grid
8	Scotland Council for Development and Industry (SCDI)
9	Scottish Water
10	Lerwick Port Authority
11	Shetland Catch
12	Shetland Leasing and Property Developments Limited

## Secretary of State's Direction to SHEPD

### **Shetland Direction made by the Secretary of State for Energy and Climate Change pursuant to sections 7(3)(a) and 107 of the Electricity Act 1989**

#### **Title, commencement and duration**

1.—(1) This direction is made by the Secretary of State for Energy and Climate Change (“the Secretary of State”) pursuant to sections 7(3)(a) and 107 of the Electricity Act 1989<sup>(2)</sup> (“the Act”) and may be referred to as the Shetland Direction.

(2) This direction has effect beginning with 1st April 2015 (“the commencement date”) and ending with the date on which it is revoked.

#### **Interpretation**

2. In this direction—

“domestic premises” means premises at which a supply is taken wholly or mainly for domestic purposes;

“the licensee” means Scottish Hydro Electric Power Distribution Plc (SHEPD);

“non-domestic premises” means premises other than domestic premises;

“Shetland” has the meaning given in the Electricity Act 1989 (Uniform Prices in the North of Scotland) Order 2005<sup>(3)</sup>.

#### **Scope**

3. This direction applies to the licensee and is the direction referred to in paragraph 6 of heading 4 (“Relevant conditions attached to our determination”) of the document with the title “Authority’s determination of SHEPD’s submission required under Charge Restriction Condition 18A” and dated 22nd April 2014.

#### **Obligations**

4.—(1) The Secretary of State directs that the licensee must administer the charges payable by a supplier for use of the licensee’s distribution system with a view to ensuring that the wholesale price of electricity supplied to non-domestic premises in Shetland does not take into account the geographical location of the premises.

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<sup>(2)</sup> 1989 c.29

<sup>(3)</sup> SI 2005/490

(2) Subparagraph (1) applies—

- (a) in relation to a supply of electricity to non-domestic premises in Shetland with a connection provided under a connection agreement made on a date specified in the first column of the table for a connection capacity specified in the second column of the table—

<i>Date of connection agreement</i>	<i>Connection Capacity</i>
Before or on the commencement date	Any capacity
After the commencement date	Capacity up to and including 2 Mega Volt Amps

- (b) in relation to a supply of electricity to non-domestic premises in Shetland with a connection agreement specified in the first row of the table where—
  - (i) on a date after the commencement date, the agreement is altered or renewed; and
  - (ii) the agreement relates to a supply of electricity to the same premises.

(3) Subparagraph (1) does not apply—

- (a) in relation to a supply of electricity to non-domestic premises in Shetland with a connection provided under a connection agreement made after the commencement date for a capacity exceeding 2 Mega Volt Amps;
- (b) in relation to a supply of electricity to non-domestic premises in Shetland with a connection agreement specified in the second row of the table where—
  - (i) on a date after the commencement date, the agreement is altered or renewed;
  - (ii) as a result of the alteration or renewal, the agreed connection capacity exceeds 2 Mega Volt Amps; and
  - (iii) the agreement relates to a supply of electricity to the same premises.

(4) In relation to a supply of electricity mentioned in subparagraph (3) the licensee may apply charges to the relevant supplier for use of the licensee’s distribution system with a view to reflecting the cost of electricity generation in Shetland to the extent that the licensee incurs that cost.

(5) For the purpose of subparagraphs (2)(b) and (3)(b), the factors to be considered in determining whether a connection agreement relates to a supply of electricity to the same premises include—

- (a) the meter point administration number of the meter measuring the supply of electricity to the premises in relation to which the agreements were concluded;
- (b) the address of those premises; and
- (c) the Ordnance Survey grid reference for the premises.

Signed by [ INSERT NAME OF OFFICIAL , ] [an official of the Department of Energy and Climate Change duly authorised by] the Secretary of State.

[INSERT DATE]



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Department of Energy & Climate Change

3 Whitehall Place

London SW1A 2AW

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