

APPENDIX A**SDEN Pricing Policy (Including Tariff Setting)****1. Aims and Objectives**

SDEN aims to provide a high quality service for customers to use to meet their heating and domestic hot water requirements within their building or homes. To achieve this SDEN will be operating on a commercial basis to deliver returns to its shareholder.

Therefore SDEN will operate a fair pricing policy where customers' heat charges are set to offer price parity and where possible a cost saving against the alternative whole life cycle cost of heat that each customer would otherwise pay. However, it will not offer heavily discounted supplies of heat to any consumer or group of consumer.

This objective is consistent with the method of heat pricing operated by the existing major private sector organisations operating in the heat service market and that endorsed by the Government.

2. Price Setting Methodology

As a general principle SDEN will develop its prices to offer parity and where possible a saving against the alternative whole life cycle cost of heat that the consumer would otherwise pay for heat supplies from a standard alternative heat source in their own building or dwelling. This is known as the "avoided cost" heat price setting methodology. The alternative method of setting prices i.e. to simply recover whatever costs SDEN incurs is known as "cost recovery" and is seen as bad practice. This is because it does not encourage the development of efficient or cost effective energy generation and distribution systems.

This avoided cost method is also consistent with the way heat charges levied by other schemes across the UK as well as the forthcoming national Heat Price Comparator for residential schemes. This method will generate a heat price which compares the costs of heat from SDEN with a basket of alternative costs including:

- Fuel
- Boiler operating and maintenance costs
- Boiler repair costs
- Boiler replacement costs

which would have otherwise been incurred by the customer.

APPENDIX A**3. Pricing for Residential and Commercial Customers**

SDEN will be entering into contracts to supply heat to both residential and commercial customers.

For residential customers SDEN will set a standard heat price which applies across all developments connected to the SDEN network. This will ensure that there is a consistent heat price across all residential developments because differential pricing for residential customers on the same heat network (who will have had no part in negotiating the price they pay) is seen as unfair and difficult to justify.

For commercial customers the heat prices and the levels of savings will be set on a case by case basis. This is because the combination of elements which make up the alternative whole life cycle cost of heat for each customer will vary widely, depending on their energy demands/consumptions, age of boiler and approach to boiler maintenance.

Once this alternative whole life cycle cost is developed for each customer, the starting point will be to offer price parity due to the low carbon nature of the heat supplies from SDEN. However, if required to secure the connection a saving will be offered during the negotiations but this will be minimised and will not exceed the level which results in that connection failing the financial hurdles (i.e. Internal Rate of Return – IRR) required to obtain the necessary investment required to link that consumer to the scheme.

4. Energy Tariffs

Once a heat price is set then this will be separated as follows:

- fixed charges – an equal charge across each month of the year
- variable charges – a charge levied on the p/kWh of heat supplied

Whilst ESCO financial good practice dictates that the level of total fixed charges should be set to at least recover all of the fixed operating costs on a monthly basis to ensure positive cash flows across the year, it is important to recognise that a very high proportion of the total energy charge being comprised of fixed charges will not encourage energy efficiency in customer's premises, because benefits from reducing their consumption will have less impact. Therefore these considerations will be taken into account when setting the specific tariffs in a fair and reasonable manner.

5. Policy Review

APPENDIX A

A review of this policy will be undertaken by the Company and if required report to the Shareholders on any proposed changes no later than 2 years from the date it is first agreed.