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Dear ,

Recovery of payments to developers through transportation charges

As you will know Ofgem has established interim arrangements for acceptance of standard licence condition (SLC) 4C charging methodologies.

These matters will be reconsidered as part of the wider review of IGT regulation and charging arrangements. Nevertheless an IGT has suggested that the interim arrangements for acceptances under SLC 4C may distort competition between IGTs, in so far as certain companies may instead be able to make excessive transportation charges using SLC 4. In particular, concern has been expressed that where excessive payments are made to developers to secure connection contracts the associated costs may be recovered through SLC 4 transportation charges. These payments could take a number of forms, including direct payments or excessive payments for civil works which do not reflect the market value of goods and services provided to the GT.

In this context it might be helpful if I set out my initial views on the interpretation of SLC 4 and 4A with respect to any such payments to developers. Where a GT recovers costs through SLC 4, charges are constrained by a reasonable profit objective set out in SLC 4A (6). SLC 4A (6) (iv) specifically excludes payments to developers 'other than by way of reasonable consideration for an interest in land or for goods and services with which the licensee is provided' from the reasonable profits test. Therefore, in assessing reasonable profits it would be appropriate to disregard any excessive payments to developers (including both direct and indirect payments). If as a consequence of this exclusion the resulting level of profits were deemed to be unreasonably high then the GT concerned would have breached SLC 4A. In these circumstances Ofgem would need to consider what sort of enforcement action to take and the GT might be subject to financial penalties pursuant to powers deriving from the Utilities Act.

If you have any comments on any aspect of the issues raised in this letter, I would be grateful for a response by the 24 May 2002. If you require any clarification of these matters please telephone me on 020-7901-7089.

Yours sincerely

Frances Warburton
Head of Gas Distribution Regulation