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BS2 0TB

Our Ref: RBA/DPC/SOC/  
Direct Dial: 020 7901 7255

cc: Nigel Turvey (by email only)

24 November 2005

Dear Colleague,

**Decision in relation to Modification Proposal to the Use of System Charging Methodology:  
Clarification of approach**

On 8 November 2005, Western Power Distribution (WPD) submitted to the Gas and Electricity Markets Authority (the 'Authority')<sup>1</sup> a proposal to modify their use of system (UoS) charging methodology for its South West and South Wales areas.

The proposal modifies the UoS charging methodology statement to clarify their approach used in deriving UoS charges in particular how they treat the assets contributed to through connection charges and indirect costs.

Having carefully considered the issues raised in the proposal, the Authority has decided not to veto the proposed modification.

This letter sets out the background to the modification proposal, explains briefly the proposed changes, and sets out the reasons for the Authority's decision.

*Background*

WPD has licence obligations<sup>2</sup> to have in place as of 1 April 2005 three charging statements: the statement of UoS methodology, the statement of use of system charges and the connection charging methodology. The statement of use of system methodology outlines the method by which distribution UoS charges are calculated. WPD has a requirement to keep the

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<sup>1</sup> Ofgem is the office of the Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.

<sup>2</sup> Standard Licence Conditions 4-4B

methodology under review and bring forward proposals to modify the methodology that it considers better facilitate achievement the relevant objectives<sup>3</sup>.

### *WPD Modification Proposal*

WPD proposes to clarify the UoS methodology statement for both licensees (South Wales and South West) in two ways:

- To provide detail in the statement on the approach taken to reflect the effect of the connection charging boundary on the derivation of yardsticks; and
- To revise the description of how they apportion the indirect costs to current terminology and approach.

The yardsticks are derived from the reinforcement cost model and reflect the different costs to each voltage or transformation level. These are used to determine the amount of revenue to a class of customer. In calculating the yardstick tariffs in WPD's charging model, WPD makes an assumption on the level of assets (costs) that will be contributed at different voltage levels by customers in their connection charge. An allowance is then made for customer contributions so that these costs are not reflected in the different voltage yardsticks. WPD have now detailed within their statement how this assessment is applied to the yardstick prices.

WPD has also amended the description of how they apportion their indirect costs to customers in line with their current terminology.

### *The Authority's decision*

The proposals are not changes to the underlying methodology but rather a change to the way the charging methodology is described in the statement. The change to the charging statement requires approval from the Authority in line with SLC4.

The Authority has considered the proposal against the relevant objectives and wider statutory duties. The change to the UoS charging methodology statement improves the clarity of the statement and provides greater detail to parties on how costs are derived from the model. This change better facilitates achievement of the relevant objectives by allowing WPD to better discharge its duties under the licence. By allowing parties to better understand the charging methodology this may further facilitate competition in supply.

The Authority has decided not to veto this modification.

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<sup>3</sup> The relevant objectives for the use of system charging methodology, as contained in paragraph 3 of standard licence condition 4 of WPD's distribution licence are:

- (a) that compliance with the use of system charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by this licence;
- (b) that compliance with the use of system charging methodology facilitates competition in generation and supply of electricity, and does not restrict, distort, or prevent competition in the transmission or distribution of electricity;
- (c) that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable (taking account of implementation costs), the costs incurred by the licensee in its distribution business; and
- (d) that, so far as is consistent with sub-paragraphs (a), (b), and (c), the use of system charging methodology, as far as reasonably practicable, properly takes account of developments in the licensee's distribution business.

Please contact Mark Cox on 0207 901 7458 or Colette Schrier on 0207 901 7239 if you have any queries in relation to the issues raised in this letter.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M Crouch', written in a cursive style.

**Martin Crouch**  
**Director, Distribution**

Signed on behalf of the Authority and authorised for that purpose by the Authority