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The Company Secretary
United Utilities Electricity plc
Dawson House
Great Sankey
Warrington
Cheshire
WA5 3LW

Your Ref: UU/003
Our Ref: RBA/DPC/SOC
Direct Dial: 020 7901 7255

cc: Simon Brooke (by email only)

19 December 2005

Dear Colleague,

**Decision in relation to Modification Proposal UU/003 to the Use of System Charging
Methodology: Housekeeping changes**

On 30 November 2005, United Utilities (UU) plc submitted a proposal, reference UU/003 to the Gas and Electricity Markets Authority (the 'Authority')¹ to modify UU's use of system (UoS) charging methodology statement.

The proposal modifies the UoS charging methodology statement for various changes identified as part of a review of the UoS methodology. The changes are designed to clarify and update UU's methodology statement.

Having carefully considered the issues raised in the proposal, the Authority has decided not to veto this 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

UU has licence obligations² to have in place as of 1 April 2005 three charging statements: the UoS charging methodology statement, the statement of UoS charges and the connection charging methodology statement. The UoS charging methodology statement outlines the method by which distribution UoS charges are calculated. UU has a requirement to keep the

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

² Standard Licence Conditions (SLC) 4-4B

methodology under review and bring forward proposals to modify the methodology that it considers better achieves the relevant objectives³.

It should be noted that this modification has been considered without reference to any changes made under the proposed modification UU/002 concerning reactive power charges. Ofgem is currently consulting on this methodology modification proposal. The text in the modified charging statement also reflects charges already approved as part of UU's modification number UU/001.

UU has also included within its modification submission a draft of a new appendix to its UoS methodology statement detailing its approach to the determination of line loss factors which is not intended for Ofgem approval. As such, this text has not been reviewed and forms no part of the comments provided in this decision letter.

UU Modification Proposal

UU proposes to clarify its UoS charging methodology statement in the following ways:

- General formatting and updating to achieve consistency in spacing, to correct typos and to update information (e.g. updating of the website address and changing 'NGC' to 'NGET' throughout the UoS charging methodology statement);
- Clarifying the treatment of metering assets, saying that these will be provided on request;
- Removing reference to the cost of Meter Asset Provision (MAP) within the part of the flowchart describing the derivation of yardstick costs within the 500MW charging model and adding these MAP costs to the end of the flowchart;
- Updating the generation charge section to remove reference to the approach used for connections near to and after 1 April 2005;
- Adding additional items to the glossary of terms.

UU states that the changes form the annual review of UU's methodology statement in order to achieve consistency, clarity, and to ensure the document is up to date.

The modification proposal report submitted by UU can be found on the Ofgem website as an attachment to this document.

The Authority's decision

The changes to the charging methodology require approval from the Authority in line with SLC4. The Authority has considered the proposal against the relevant objectives and wider statutory duties.

³ The relevant objectives for the use of system charging methodology, as contained in paragraph 3 of standard licence condition 4 of UU'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.

The general formatting of the methodology appears to improve clarity and appropriately updates it. The treatment of costs relating to Meter Asset Provision (MAP) is clarified in the text, and MAP costs have been removed from the part of the flowchart describing the derivation of yardstick costs. Referring to MAP within the 500MW model previously was factually incorrect because MAP charges are outside the derivation of charges in the 500MW model. MAP charges are combined within customer's tariffs only where applicable, and this is now reflected at the bottom of the flowchart, which now refers to DUoS tariffs with and without MAP. It is appropriate to correct this error.

The update to the section on generation charging provides a more concise methodology with wording that is appropriate and clear. The updated glossary provides further clarity to users of the statement by providing additional definitions and minor changes which ensure consistent formatting throughout.

The proposed changes improve the clarity of the methodology and better meet the relevant objectives. The Authority has decided not to veto this modification.

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,



Martin Crouch
Director, Distribution

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