

5 October 2006



The Company Secretary  
Western Power Distribution (South Wales)  
Avon Bank  
Feeder Road  
Bristol  
BS2 0TB

*Promoting choice and  
value for all customers*

Your Ref: WPD/Wales/004  
Our Ref: RBA/DPC/SOC/  
Direct Dial: 020 7901 7255

Cc: Tim Hughes (by email only)

Dear Colleague,

**Decision in relation to Modification proposal to the connection charging methodology: Clarification of the 'Voltage rule' and incremental increases.**

On 11 September 2006, Western Power Distribution ("WPD") submitted to the Gas and Electricity Markets Authority ("the Authority")<sup>1</sup> a proposal to modify its connection charging methodology for its South Wales area.

The proposal modifies the connection charging methodology statement in two ways to facilitate greater understanding of charges levied for reinforcement. It includes:

- Clarification of the 'Voltage level rule' through the inclusion of additional information over the circumstances when costs associated with reinforcement assets are subject to apportionment.
- Changes to remove a reference to incremental increases in load being taken into account when assessing contributions to existing reinforcement assets.

Having carefully considered the issues raised in the proposal, the Authority has decided to veto the proposed modification.

This letter sets out the background to the modification proposal, explains briefly the proposed changes and sets out the reason 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 use of system ("UoS") charging methodology, the statement of UoS charges and the connection charging methodology. The connection charging methodology outlines the method by which connection charges are calculated. WPD has a requirement to keep the methodology under

<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



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

#### *WPD Modification proposal*

WPD proposes to clarify the connection charging methodology statement by:

- clarifying that the 'voltage level rule', for apportioning the costs of reinforcement, applies to reinforcement of assets up to one voltage level above the voltage of the point of connection, rather than the voltage of supply;

WPD's current methodology is ambiguous in relation to the voltage level rule. It currently sets out that reinforcement costs up to one voltage level above will be apportioned to the customer. However it is not clear to parties what this applies to and whether it is the voltage of the point of connection to the existing network or the voltage of supply that will be used by WPD in determining what (if any) reinforcement costs should be charged to the connecting party.

- The removal of a reference to previous increases in load being taken into account when determining the aggregate required capacity.

The reference to incremental increases in load being taken into account when calculating the aggregate required capacity, was included as a reference to the 25% rule to assess contributions to existing reinforcement assets. The term prevented the customer from requesting just enough capacity so as not to incur any reinforcement charges and then re-applying at a later time for further capacity.

With the introduction of the Apportionment Rules on the 1 April 2005, WPD argue that the threshold is no longer applicable as the customer is asked to pay only for their required capacity. On this basis WPD consider that the term is superfluous and does not add anything to the statement.

#### *The Authority's decision*

The Authority has considered the proposal against the relevant objectives and wider statutory duties.

- Voltage level rule

This modification clarifies WPD's connection charging methodology and better details how WPD will apply the voltage level above rule. This clarification will aid customers in establishing the basis of their connection charge. The proposal to use the voltage of the point of connection to the existing network, rather than the

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

- (a) that compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by this license;
- (b) that compliance with the connection 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 connection charging methodology results in changes which reflect, as far as is reasonably practicable (taking into account of implementation costs), the costs incurred by the licensee and its distribution business; and
- (d) that, so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is practicable, properly takes account of developments in the licensee's distribution business.

voltage of supply, is more consistent with the competitive connection arrangements and independent network development. This change will bring into line the point of connection applications for contestable works and IDNO network extensions with the charging boundary.

- Incremental increases in load

WPD have stated that this term is no longer required since the 25% rule was replaced by the apportionment rules. WPD argue that it is no longer necessary because the incentive on customers to request just enough capacity to avoid costs of reinforcement and then subsequently apply for further capacity once reinforcement has been undertaken is reduced following the change in reinforcement charging rules.

The current methodology is not clear on the treatment of existing customers who ask for a further increment of capacity. Under 1.2.1 required capacity is defined as the design capacity of the connection as laid down in the connection agreement. This definition implies that in the circumstances where a customer asks for an upgrade to their connection, their existing load and new requirement are added together to obtain the required capacity. This approach is currently in conflict with the term that is proposed to be deleted under 1.2.2 "Contribution to existing reinforcement assets". This states that previous increases in load will be considered when charging for existing reinforcement assets, which implies that it is the increase in load that is used as the basis of charging.

The reference to previous increases implies that, with the apportionment rules, the customer will still be exposed to correct share of the reinforcement costs and will not be able to affect the share of the reinforcement costs based on the timing or phasing of their application.

It is therefore not clear that connection charges will be more cost reflective by removing this term. Importantly, if this term was removed, the statement, although being clearer, would then imply that required capacity includes existing and additional capacity. Such an interpretation would mean that existing customers will get a different connection charge for an upgrade to their connection capacity compared with a new customer with the same capacity increment. This is not cost reflective.

Overall, the two changes to the connection charging methodology statement improve the clarity of the statement and provide a better understanding of the charges associated with reinforcement and the circumstances under which they would be levied. The change to the voltage level rule better achieves the relevant objectives by removing ambiguity and facilitating competition in connections and distribution. However, the proposal not to consider previous incremental increases in load from existing customers does not improve cost reflectivity of the charges. Therefore on balance the modification proposal does not better facilitate achievement of the relevant objectives. Ofgem notes that greater clarity is required in the statement on both these issues.

The Authority has therefore decided to veto the modification to the connection charging methodology statement.

Please contact Laura Nell on 020 7901 7201 if you have any queries in relation to the issues raised in this letter.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'M. Crouch', with a long horizontal flourish extending to the right.

Martin Crouch

**Director, Distribution**

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