



The Company Secretary  
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*Promoting choice and  
value for all customers*

Your Ref: COM-06-001  
Our Ref: RBA/DPC/SOC  
Direct Dial: 020 7901 7255

Cc Tony McEntee (by email only)

15 November 2006

Dear Colleague,

**Decision in relation to modification proposal to the connection charging methodology: Reasonable rate of return on the costs included in the connection charge.**

On 20 October 2006, Scottish Power Distribution Ltd ("SPD") submitted to the Gas and Electricity Markets Authority ("the Authority")<sup>1</sup> a proposal to modify its connection charging methodology.

The proposal modifies the connection charging methodology statement by providing clarification of what is included in the connection charge through the inclusion of additional information over the make-up of the charge.

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*

SPD has licence obligations<sup>2</sup> to have in place as of 1 April 2005 three charging statements: the statement of use of system charging ("UoS") methodology, the statement of UoS charges and the connection charging methodology. The connection charging methodology outlines the method by which connection charges are calculated. SPD has a requirement to keep the methodology under review and bring forward the proposals to modify the methodology that it considers better facilitate achievement of the relevant objectives.<sup>3</sup>

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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

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

### *SPD Modification proposal*

SPD proposes to clarify the connection charging methodology statement by:

- expanding the section that outlines the components of the connection charge by adding a sixth component which states that the charge will reflect a reasonable rate of return on the capital represented by the cost of assets to connect a party.

SPD state that the proposed modification change will allow the methodology to better meet the relevant objectives as set out in SLC 4B paragraph 3.

### *The Authority's decision*

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

The Authority notes that SPD is entitled, in accordance with SLC4B 7(b) to recover a reasonable rate of return on capital employed. SPD's existing connection charging methodology states that the connection charge is payable in full with the acceptance of the quote, although some large schemes may be eligible for phased payments. SPD's modification proposal does not make clear the circumstances in which SPD will incur costs upfront of providing connections. As such, the Authority considers that there is limited scope for the licensee to incur capital expenditure which will warrant a rate of return. Although consistent with the provisions of the licence, due to the connection charging methodology currently employed (i.e. charging upfront), the inclusion of this component could create confusion over the nature of the connection charge and the associated payment terms. This would result in a less transparent connection charging methodology.

The Authority has 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,



Martin Crouch  
Director, Distribution

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

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- (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 licence;
  - (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 charges 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.