

The Company Secretary  
Northern Electric Distribution Limited  
98 Aketon Road  
Castleford  
WF10 5DS

cc: Andy Jenkins (by email only)  
Harvey Jones (by email only)

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*Promoting choice and  
value for all customers*

Your Ref: 0003/2006  
Our Ref: RBA/DPC/SOC  
Direct Dial: 020 7901 7255

17 November 2006

Dear Colleague,

**Decision in relation to modification proposal 0003/2006 to the statement of use of system charging methodology: Treatment of EHV dedicated assets**

On 30 October 2006 CE Electric UK plc submitted a proposal, reference 0003/2006, to the Gas and Electricity Markets Authority (the 'Authority')<sup>1</sup> to modify Northern Electric Distribution Limited's (NEDL's) statement of Use of System (UoS) charging methodology.

The proposal modifies the statement of UoS charging methodology by adding additional equations for charging for sole use assets to EHV customers. The changes are designed to provide greater transparency and clarification in the methodology statement on CE Electric's current approach to the EHV asset valuation and operational repair and maintenance (OR&M) charges. It is proposed that these equations only apply where sole use assets have been replaced and the costs have not been recovered from customers through connection charges.

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 reasons for the Authority's decision.

*Background*

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

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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

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

### *NEDL Modification Proposal*

NEDL proposes to clarify its statement of UoS charging methodology by inserting a second equation in both the asset valuation and OR&M parts of the EHV section to take into account sole use assets. These equations will only apply where the assets have been replaced and the replacement has been paid for by NEDL.

At the time of connection, sole use assets would normally be paid for by the customer. NEDL advise that at the end of their asset lives, they would typically be replaced at NEDL's expense and therefore the cost needs to be recovered through UoS charges.

Currently the methodology specifies that EHV UoS charges will be based on the valuation of upstream assets which is apportioned to the customer by taking the customer's agreed capacity as a proportion of the asset rating. This valuation is used in calculating the **annual depreciation and rate of return elements of the customer's UoS charge**. The current methodology details that sole use assets will not be included as part of this asset valuation.

The proposal says that for dedicated or sole use assets the asset value will be apportioned between demand and generation requirements in proportion to the ratio of the required demand and generation capacity of the connection. Similarly, the same approach is proposed for determining OR&M costs for sole use assets used for generation and demand.

### *The Authority's decision*

In keeping with its statutory principal objective and general duties, the Authority has considered the proposal against the relevant objectives of the licence condition.

The Authority considers that the proposed change to the statement of UoS charging methodology has not been shown to better achieve the relevant objectives. In particular:

- It is not clear that allocating costs between demand and generation based on agreed capacities will accurately reflect the costs imposed on NEDL's network by those parties. In effect the cost of the sole use asset may be driven by one or the other such that the simple allocation proposed may not be cost reflective.

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

- (a) that compliance with the UoS 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 UoS 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 UoS 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 UoS charging methodology, as far as reasonably practicable, properly takes account of developments in the licensee's distribution business.

- It is proposed that these new equations be inserted in the section covering EHV demand charges yet NEDL hasn't proposed to mirror these equations in the section covering the methodology for calculating EHV generation charges.
- The proposed methodology is further complicated as existing customers<sup>4</sup> are not currently subject to generator use of system charges (GDUoS), hence in most cases where the proposed equation applies, less than 100 percent of the cost associated with the sole use asset will be recovered from the customer in the demand use of system charge (DUoS), and the shortfall will be recovered by NEDL across all other customers.
- The proposed drafting results in ambiguity regarding how NEDL will recover the cost of replacing sole use assets for EHV customers. The proposal seeks to provide the option to recover these costs through UoS charges without being definitive about when the costs will be recovered through UoS and when additional connection charges will apply. NEDL's connection charging methodology does not provide clarity, stating that where sole use connection assets need to be replaced customers will pay additional connection charges if the cost is not recovered through UoS charges.

The Authority has decided to veto this modification.

Please contact Cherie Davis on 020 7901 7210 if you have any queries in relation to the issues raised in this letter.

Yours faithfully,



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

Authorised for that purpose by the Authority

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<sup>4</sup> Generator use of system charges were introduced for new connections with effect from 1 April 2005 but existing generators connected before this time will receive a full rebate until at least 2010.