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*Promoting choice and
value for all customers*

Your Ref: WPD/WALES/006
Our Ref: RBA/DPC/SOC
18 January 2007

Direct Dial: 020 7901 7255

Dear Colleague,

Decision in relation to modification proposal to the connection charging methodology: Clarification relating to incremental increases in Required Capacity

On 5 December, WPD submitted to the Gas and Electricity Markets Authority ("the Authority")¹ a proposal to modify its connection charging methodology for its South Wales area.

The proposal modifies the connection charging statement by clarifying the calculation of Required capacity for both existing customers and for new customers wishing to connect to the system. The proposal also clarifies the circumstances under which contribution to existing reinforcement assets are made.

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 reason for the Authorities decision.

Background

WPD has licence obligations² to have in place as of 1 April 2005 three charging statements: the statement of use of system (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. WPD 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.³

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

² Standard licence conditions 4-4B

³ 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 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.

WPD Modification proposal

The proposal seeks to clarify the calculation of Required Capacity by:

- Stating that for a new Connection, Required Capacity means the design capacity of the connection at the Exit Point, as agreed between the connecting party and WPD.
- Stating that for an existing customer seeking augmentation to an existing connection, the Required Capacity means the difference between the existing and augmented design capacity of the connection at the Exit Point.

The proposal seeks to clarify contributions to existing reinforcement assets by:

- Stating that where spare capacity is created on the system, due to the incremental nature of reinforcement undertaken for a new connectee or in augmenting the capacity of an existing connectee, WPD will recover a large proportion of these costs through Use of System tariffs. WPD also state that if a subsequent party connects to the system and uses some of the spare capacity created due to previous reinforcement, that this party can expect to be charged a proportion of the initial reinforcement costs.
- Stating that where an initial connectee requests a further increase in capacity, a proportion of reinforcement costs will be charged to the initial party within the prescribed periods.

In April 2006 Ofgem produced a discussion note on the Apportionment rules. This note highlighted the free rider problem which could arise due to the incremental nature of reinforcement. The proposal addresses this problem and makes it clear that both the initial and any subsequent parties can expect to pay a proportion of the reinforcement if they wish to use any of the headroom created due to any previous reinforcement work undertaken.

The April 2006 discussion note also highlighted the ambiguity of references to the 'voltage of connection' being used to calculate the Required Capacity. The proposal states that the Voltage at the Exit Point (as agreed between the connecting party and WPD) will be used to calculate Required Capacity.

The Authority's decision

The Authority has considered the proposal against the relevant objectives and wider statutory duties. The change to the connection charging statement better achieves the relevant objectives. In clarifying the definition of Required Capacity for both initial customers seeking connection and existing customers seeking augmentation, WPD allow customers to make a better estimate of the charges for which they would become liable.

In making it clear that customers seeking to utilise any headroom created on the WPD system due to previous reinforcement can expect to pay for a proportion of the initial reinforcement costs, WPD are improving the cost reflectivity of their charges

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- (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.

The Authority has decided not to veto the modification to the connection charging methodology statement.

Please contact Nicola Love on 0207 901 7036 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 horizontal line extending to the right.

Martin Crouch
Director, Distribution
Signed on behalf of the Authority and authorised for that purpose by the Authority