

Modification proposal:	<b>Gas Distribution Connection Charging Methodology: [CCM]: Least Cost Scheme (SGN 001)</b>		
Decision:	The Authority <sup>1</sup> directs that this proposal be made <sup>2</sup>		
Target audience:	Gas Distribution Network Operators, Independent Gas Transporters, Independent Connection Providers and other interested parties		
Date of publication:	31 July 2009	Implementation Date:	01 September 2009

## Background to the modification proposal

This modification seeks to clarify the definition of least cost that is applied to the design solution for a connection to the gas distribution network which is detailed within the Connection Charging Methodology (CCM).

In accordance with paragraph 3 of Standard Licence Condition 4B (SLC4B), of the Gas Transporter (GT) licence, the licensee has an obligation to determine and comply with an Authority approved connection charging methodology by 1 April 2008. Paragraph 6 of SLC4B provides that the licensee shall not make a modification to the connection charging methodology unless the Authority has been furnished with a report about the modification in accordance with paragraph 6((a),(b) and (c) of SLC 4B(6) and provided the Authority has not directed, within 28 days (or within three months if it intends to undertake an impact assessment), that the modification shall not be made.

Before 1 April 2008, the above mentioned licence requirements did not exist. As such, GTs were able to amend their connection charging methodology without requiring the Authority's approval. This resulted in various inconsistencies in the CCMs of licensees.

Therefore, to ensure consistency in the charging methodologies, SLC4B of the GT licence was amended on 1 April 2008.

In considering approval of the CCM for the first time, we asked GTs to review their respective connection charging methodologies before seeking approval. Each of the GTs submitted their revised CCM modifications to the Authority in February 2009 and Southern Gas Networks plc' (SGN) was subsequently approved on 27 February 2009. However, during this process it was noted that all GTs needed to examine the definition of a 'least cost' connection scheme contained within the methodology. This describes the method used to calculate the lowest cost of connections. It was agreed that further clarification was needed to this definition to ensure consistency across all GT areas. SGN raised the 'Least Cost Scheme' (SGN 001) modification ("the modification") to address this issue.

## The modification proposal

In our decision<sup>3</sup> letter for the GTs connection charging methodologies we recognised the inconsistent approach amongst the GTs as to how 'least cost' is determined in their respective methodologies. We noted that some GTs defined 'least cost' as the lowest

<sup>1</sup> The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

<sup>2</sup> This document is notice of the reasons for this decision as required by section 38A of the Gas Act 1986.

<sup>3</sup> This can be found on our website at the following

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=197&refer=Networks/GasDistr/GasDistrPol>

overall cost of construction of the network, while others also included operational costs. We therefore indicated that we expected SGN and the other GTs to consult and agree on a common method for calculating 'least costs' as soon as practicable, and to propose amendments to their respective connection methodologies. In making this statement, we noted that in electricity distribution we are working hard to introduce common methodologies and we expected the GTs to move in this direction.

In response to this SGN proposed the following modification to section 2.1 (Connection Design Philosophy) of its gas distribution connections charging methodology:

*SGN will construct apparatus on least project cost fit for purpose basis taking into account the customer's requirements and our statutory obligations. This means that where there are different fit for purpose design solutions, which meet a customer's requirements, SGN will select the one that is anticipated to have the lowest overall whole life cost of construction and maintenance. However the customer will only be charged for the lowest cost fit for purpose scheme; this means that any upgrading of the lowest cost fit for purpose scheme to comply with any additional requirements of SGN, such as to take into account future development, will not be charged to the customer requesting the connection.*

**'Fit for purpose'** refers to a design that satisfies the required engineering standards that will safely transport the required quantity of gas at an appropriate pressure throughout the life of the apparatus taking into account the Gas Act obligation for economic pipe-line system development.

SGN considers that The proposed modification provides greater clarity and therefore better achieves the relevant objectives. In particular, SGN consider the proposed modification would better achieve relevant objective 5(a) of Standard Condition 4B by better describing the principles the networks apply in facilitating connections and determining charges for connection in accordance with the duties under the Act and the licence.

## **The Authority's decision**

**The Authority has considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 21 July 2009. The Authority has concluded that:**

- 1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives<sup>4</sup> of the Connection Charging methodology; and**

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<sup>4</sup> The relevant objectives contained in paragraph 5 of SLC 4B are:

- (a) compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;
- (b) compliance with the connection charging methodology facilitates competition in the supply of gas, and does not restrict, distort, or prevent competition in the transportation of gas conveyed through pipes;
- (c) compliance with the connection 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 transportation business and, where the Act enables, to charge a reasonable profit;
- (d) so far as is consistent with sub-paragraphs (a), (b) and (c), the connection charging methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's transportation business; and

- 2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties<sup>5</sup>.**

### **Reasons for the Authority's decision**

The Authority agrees with SGN that the modification would better facilitate achievement of relevant objective 5(a). The Authority considers a clear definition of least cost that is consistent across all GTs will facilitate the discharge of GTs' duties in respect of connections as set out in section 9 of the Gas Act 1986. A consistent definition of least cost should ensure connection charges are calculated using a similar method across all GT areas.

Further to this a consistent definition of 'least cost' should ensure compliance with paragraph 1(a) of section 9 of the Gas Act 1986 which specifies that GTs must develop and maintain an efficient and economical pipe-line system for the conveyance of gas. A consistent method for 'least cost' should ensure all GTs identify similar costs when developing their network, thereby ensuring that all efficiently incurred cost are accounted for and targeted at the parties that benefit from them. For these reasons we consider the modification better achieves relevant objective 5(a) of SLC 4B.

### **Decision notice**

**In accordance with Standard Condition 4B of the Gas Transporters Licence, the Authority, hereby directs that modification proposal CCM: 'Least Cost Scheme: SGN 001' be made.**

**This document also constitutes the Notice of reasons for the decision under s38A(2) of the Gas Act 1986.**



**Rachel Fletcher, Director Distribution**

**Signed on behalf of the Authority and authorised for that purpose.**

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(e) compliance with the connection charging methodology ensures that the licensee shall not show any undue preference towards, or undue discrimination against, any person who operates, or proposes to operate, a pipe-line system in relation to the connection of that system to the pipe-line system to which this licence relates.

<sup>5</sup>The Authority's statutory duties are wider than the relevant objectives of SLC 4B paragraph 5 and include numerous statutory instruments and directly effective EC legislation..