

Modification proposal:	Connection Charging Methodology Statement Modification for Wales & West Utilities Limited (our ref: WWU002): Change to Connection Design Philosophy		
Decision:	The Authority ¹ directs that this proposal is not vetoed		
Target audience:	Gas Distribution Networks customers and other interested parties		
Date of publication:	21 July 2010	Implementation Date:	26 July 2010

Background to the modification proposal

In accordance with paragraph 3 of Standard Condition 4B (SLC4B), of the Gas Transporter (GT) licence, a licensee has an obligation to have in place and comply with a connection charging methodology approved by the Gas and Electricity Markets Authority ("the Authority"). A licensee is required to review its methodology at least once a year and make any modifications that are necessary for the purpose of achieving the "relevant objectives" specified in paragraph 5 of SLC4B.²

Paragraph 6 of SLC4B provides that a licensee shall not make a modification to the connection charging methodology unless the Authority has been furnished with a report that (a) indicates the terms proposed for modification, (b) outlines how the proposed modification would better achieve the relevant objectives and (c) sets out a timetable for its implementation.

A modification cannot be made if, within 28 days of receiving the aforementioned report, the Authority gives a direction to the licensee that the modification shall not be made. In coming to a decision whether to veto a proposed modification or not we will review it against the relevant objectives and our Principal Objective and wider statutory duties.

WWU ("the licensee") has introduced a more comprehensive system for reporting and recording the costs of work associated with connections. This new system allows WWU to identify costs at a more granular level. In particular, WWU can now identify the costs of individual connection jobs.

The modification proposal

On 29 June 2010, WWU submitted its proposed connection charging methodology modification 002 to the Authority for approval. WWU proposed changes to sections 3.2.1,

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

² For the purposes of SLC4B these 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
- (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.

3.2.2 and 3.2.4 of its Connection Charging Methodology (“the methodology”) as outlined below.

WWU proposes to introduce a change to section 3.2.1 of the methodology that would allow it to adjust cost data, where appropriate, to take into account inflation so that standard charges reflect costs at the time they will be applied. The licensee argues this change will ensure that standard charges better reflect the costs of connection, thereby facilitating the discharge of WWU’s statutory duty³ to develop an efficient and economic pipeline, in accordance with relevant objective (a).

The proposed modification of section 3.2.2 of the methodology seeks to enable WWU to use data from its new cost reporting system in the calculation of its standard connection charges. WWU currently sets its standard connection charges based on the assessment of trained observers using work measurement techniques. The modification would introduce a change to WWU’s connection charging methodology whereby its standard connection charges would be based on an analysis of labour and materials costs from a sample of completed jobs within the preceding twelve months and on estimates from trained observers. The licensee considers that this change will better meet relevant objectives (a) and (c) because the use of more cost data and, in particular, actual cost data will mean that its connection charges will more accurately reflect the costs of undertaking connections.

In addition to the above, WWU proposes to make a small number of clarificatory changes to the sections 3.2.2 and 3.2.4 of the methodology.

Specifically, WWU proposes to introduce the phrase a “profit element where applicable” in section 3.2.2 of the methodology. WWU wish to introduce this phrase to more accurately reflect their current practice for connection charging. This practice, in accordance with Section 10 of the Gas Act 1986, does not allow a profit element to be added to standard connection charges for connections made under Section 10 of the Gas Act 1986, but does allow for a profit element to be charged in respect of other connections.

WWU also proposes to reword the description of the “Domestic Load Connection Allowance” in section 3.2.4 of its methodology, again for clarificatory purposes.

WWU consider that these clarificatory changes will give customers a greater understanding of the methodology and allow them to make more informed decisions regarding connection to the gas distribution network, thereby facilitating the discharge of WWU’s statutory duty to develop an efficient and economic pipeline (see footnote 3), in accordance with relevant objective (a).

In the modification report, the licensee maintains that the proposed changes will be neutral against relevant objectives (b), (d) and (e).

Reasons for the Authority’s decision

Having reviewed the proposed modification against the relevant objectives and our wider statutory duties, we have decided to not veto it. Below we set out the reasons for our decision.

We agree with WWU that the application of inflation factors (where appropriate) to standard costs, provided for in section 3.2.1 of the proposed methodology, would better facilitate relevant objective a). This is because this change would allow standard charges to reflect

³ See section 9, Gas Act 1986.

costs at the time that the charges are to be applied providing more accurate price signals to parties wanting to connect to WWUs' network.

We also agree that the proposed change in section 3.2.2 of the methodology enabling WWU to use data from its new system in setting standard connection charges will better facilitate relevant objectives (a) and (c). This change will allow more cost information and information based on recent actual cost data to be used in setting standard charges. This should result in charges that more closely reflect actual costs incurred than charges based solely on estimates of trained observers.

We consider that the changes to introduce the phrase "profit where applicable" in section 3.2.2 of the methodology does reflect the practice of the licensee and is in accordance with Section 10 of the Gas Act 1986. Including this term in the methodology will facilitate better understanding of connection charges by customers and, therefore, allow the licensee to better achieve its obligation to develop an economic and efficient network in accordance with relevant objective (a).

Regarding the proposed rewording of section 3.2.4, we agree with the licensee that the new wording is clearer so as to facilitate better understanding of connection charges by customers and, therefore, allow the licensee to better achieve its obligation to develop an economic and efficient network.

We consider that overall the changes will also better achieve relevant objective (b). This is because improvement in the cost reflectivity of connection charges and an improved understanding of the charges by customers could alleviate possible distortions in competition caused by inaccurate or misunderstood connection charges.

Having reviewed the changes against relevant objectives (d) and (e), we agree that they are neutral against these objectives. The changes do not reflect developments in WWU's transportation business. Further, as the changes will apply uniformly to all connection customers, they do not result in undue preference or discrimination against any person.

Decision Notice

In accordance with Standard Condition 4B of the Gas Transporters' licence, the Authority has decided to approve the modified connection charging methodology proposed by the licensee.

**Rachel Fletcher, Partner, Distribution
Signed on behalf of the Authority and authorised for that purpose**