

Modification proposal:	<b>Amendment proposal to Western Power Distribution's<sup>1</sup> ("WPD's") Connection Charging Methodology – Explanation of margins applied to charges on contestable services: WPD/024</b>		
Decision:	The Authority's <sup>2</sup> decision is that this proposal is not vetoed <sup>3</sup>		
Target audience:	DNOs, IDNOs, Suppliers, Generators and other interested parties		
Date of publication:	24 February 2012	Implementation Date:	1 March 2012

## Background to the modification proposal

In accordance with Standard Licence Condition ("SLC") 13 of its Electricity Distribution Licence, WPD is required to have in force at all times a connection charging methodology ("Methodology"), which we have approved on the basis that it achieves the relevant objectives<sup>4</sup>. WPD must review the Methodology at least once every year and make such modifications (if any) to the Methodology as are necessary for the purpose of better achieving the relevant objectives.

Since July 2010, each DNO's connection charging methodology has consisted of a common section ("The Common Methodology") and a company specific section ("The Company Specific Methodology"). These form sections 5 and 6 of each DNO's connection charging document respectively<sup>5</sup>.

At Distribution Price Control Review 5 ("DPCR5") we introduced measures to incentivise DNOs to facilitate competition in connection services. For this purpose we defined nine Relevant Market Segments ("RMS") in which we considered competition in contestable connections services to be viable. DNOs may make applications based on alternative market segments if they wish. If and when a DNO demonstrates to us that competition is effective it may charge an unregulated margin in that RMS. Where we do not consider competition is effective the DNO must charge a regulated margin of 4%. The regulated margin is intended to provide 'head room' to allow competition to develop.

## DNO's modification proposal

On 31 January 2012, WPD submitted a modification proposal to make changes to its Company Specific Methodology to introduce a table which details the type of margin WPD

<sup>1</sup> WPD owns two electricity distribution licensees – Western Power Distribution (South Wales) and Western Power Distribution (South West). This letter applies to both licensees.

<sup>2</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>3</sup> This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

<sup>4</sup> The 'relevant objectives' for the connection charging methodology, as contained in paragraph 3 of Standard Licence Condition 13 of the licence are:

- (a) that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Electricity Act 1989 and by its licence;
- (b) that compliance with the methodology facilitates competition in the 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 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 methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's Distribution Business.

<sup>5</sup> <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=722&refer=Networks/ElecDist/Policy/DistChrgMds>

is charging (regulated or unregulated) in each of the RMSs in its areas. All DNOs have proposed to make similar changes and these changes have been discussed at the Connections Commercial Operations Group ("COG") sub group<sup>6</sup>.

WPD considers the changes will provide additional clarity to customers, as they will be able to see whether an unregulated or regulated margin is being charged in each RMS.

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

The Authority has decided **not to veto** WPD's proposals. In reaching our decision we have considered the proposed modifications against the relevant objectives and our principal objectives and wider statutory duties<sup>7</sup>.

We note that in the current methodology DNOs may recover the reasonable costs incurred, both direct and indirect, in providing a connection and may, where allowed by their Licence, apply a margin to some of those costs. WPD's proposed changes introduce a table describing in more detail the type of margin charged in particular circumstances. We consider that WPD's proposal provides additional clarity to their Methodology while not making any significant changes to the current arrangements.

Our decision is based on WPD's proposals better achieving relevant objectives, (a), (b) and (d) and not affecting relevant objective (c). The reasons for our decisions are set out below.

#### **Relevant objective (a) - that compliance with the methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by this licence;**

Under SLC 13, the DNOs are obliged to have in force at all times a Charging Methodology<sup>8</sup> that is a '*complete and documented explanation, presented in a coherent and consistent manner, of the methods, principles, and assumptions that apply in relation to connections, for determining the licensee's Connection Charges.*'

Paragraph 5.7 of WPD's Methodology already states that a margin may be applied to some costs: "*We may recover the reasonable costs incurred, both direct and indirect, in providing a connection and may, where allowed by our Licence, apply a margin on some of those costs.*" Although it does not state what type of margin may be applied and to which services it may be applied. The proposed changes make it clearer to the customer under what circumstances an unregulated or regulated margin is being charged. We consider this makes WPD's Methodology more transparent and complete. Therefore we consider that the proposals better facilitate the discharge of this obligation.

#### **Relevant objective (b) - that compliance with the methodology facilitates competition in the generation and supply of electricity, and does not restrict, distort, or prevent competition in the transmission or distribution of electricity;**

WPD's proposals will provide customers with information on if an unregulated or regulated margin is being charged in an RMS. This may facilitate competition in the

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<sup>6</sup> The COG sub group meets regularly to discuss improvements of commercial and contractual services provided to network users.

<sup>7</sup> The Authority's statutory duties are detailed mainly in the Electricity Act 1989, Gas Act 1986, Utilities Act 2000, Competition Act 1998, Enterprise Act 2002, the Energy Act 2004 and European legislation.

<sup>8</sup> As defined under SLC 1

connections markets as customers may find it easier to make an informed choice between connection providers based on this information. Therefore, we consider that WPD's proposals better achieve relevant objective (b).

**Relevant objective (d) – that so far as is consistent with sub paragraphs (a), (b) and (c), the methodology, as far as is reasonably practicable, properly takes account of developments in the licensee's distribution business.**

As part of DPCR5 the DNOs are incentivised to facilitate competition in connection services and apply to the Authority to charge an unregulated margin in an RMS where they consider competition to be effective. The proposed changes outline where a DNO has passed the "competition test" in any RMS. We therefore consider that WPD's proposal takes account of developments in the licensee's distribution business and better achieves relevant objective (d).

If you have any questions relating to the issues discussed in this letter please contact Nicola Meheran at [nicola.meheran@ofgem.gov.uk](mailto:nicola.meheran@ofgem.gov.uk) or on 0207 901 0515.

Yours faithfully,



Andrew Burgess,  
**Associate Partner, Transmission and Distribution Policy**  
**Signed on behalf of the Authority and authorised for that purpose**