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*Promoting choice and value for
all gas and electricity customers*

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Dear Malcolm,

Southern Gas Networks plc (Southern Gas Networks): Approval of revised Connection Charging Methodology 4B

On 30 October 2012, your colleague, Gwen MacIntyre, submitted to us¹ a modification to Southern Gas Networks' connection charging methodology. The modification proposes to add a note to the description of the economic test (Annex E) to clarify the treatment of the Exit Capacity Network (ECN) transportation charge introduced on 1 October 2012.

Having reviewed the modification, we have decided not to veto it. This letter sets out the background and explains the reasons for our decision.

Background

Gas Distribution Economic Test

The economic test is a financial assessment tool that ensures that Gas Distribution Networks (GDNs) meet their obligations under the Gas Act 1986 (the Act) to develop and maintain an efficient and economical pipeline system and to comply with any reasonable request to connect to their system any premises or any pipeline system operated by an authorised transporter.

The economic test is used to identify new requests for capacity on the network where the level of investment would be considered 'uneconomic'. The test compares the cost of distribution network reinforcement and additional operating costs of accommodating the new load with the additional distribution transportation revenue from the load.

Changes to Exit capacity charges

Following changes to the National Transmission System (NTS) Exit Capacity regime from 1 October 2012, the charging methodology will change so as to introduce a new ECN transportation charge. There are no further changes to the GDN transportation charges.

Revisions to Southern Gas Networks' Charging Methodology 4B

Following the introduction of the new ECN transportation Charge, you have inserted a note in Annex E under the description of the economic test to clarify that the costs associated with additional exit capacity bookings and the revenue from the new ECN charge are

¹ The Gas and Electricity Markets Authority. Ofgem is the Office of the Gas and Electricity Markets Authority.

excluded from the Gas Distribution Economic Test. This is because GDNs are allowed to fully recover their costs, and revenue and costs are therefore assumed to be equal with no cost impact for the individual load.

This addition does not alter the connection charging methodology, it merely provides clarification of the treatment of the ECN charge.

Our Decision

On 30 October 2012, you submitted this modification to your connection charging methodology to us, along with a modification report. After reviewing the revised methodology and the modification report, we are satisfied that it would better achieve the relevant objectives set out in Standard Licence Condition (SLC)4B paragraph 5 (a), (c) and (d) and that its impact on the other relevant objectives is neutral. We are also satisfied that not vetoing the modification is consistent with our principal objective and statutory duties.

SLC 4B paragraph 5 (a) Compliance with the connection charging methodology facilitates the discharge by the licensee of the obligations imposed on it under the Act and by the license.

The modification clarifies the treatment of the ECN charge for the purposes of the economic test.

SLC 4B paragraph 5 (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.

The modification clarifies how the new charge is treated and that it reflects the costs incurred by Southern Gas Networks in its transportation business.

SLC 4B paragraph 5 (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.

The modification updates your charging methodology to reflect the new exit capacity arrangements which came into effect on 1 October 2012.

Decision Notice

In accordance with Standard Condition 4B of the Gas Transporters' licence, the Authority has decided not to veto this modification of the connection charging methodology of Southern Gas Networks.

Yours sincerely,



Andrew Burgess

Associate Partner, Transmission and Distribution Policy

Signed on behalf of the Authority and authorised for that purpose