

Modification proposal:	Connection and Use of System Code ("CUSC") CMP306: Align annual connection charge rate of return at CUSC 14.3.21 to price control cost of capital
Decision:	The Authority ¹ directs that this modification be made ²
Target audience:	National Grid Electricity System Owner ("NGESO"), Parties to the CUSC, the CUSC Panel and other interested parties
Date of publication:	21 May 2020
Implementation date:	30 October 2020

Background

Connection Charges recover the cost of installing and maintaining connection assets which connect individual users to the GB Electricity Transmission Network³ and are determined by the Connection and Use of System Code ("CUSC").

The connection charge is calculated annually and involves a capital component and a non-capital component. The capital component reflects a real rate of return, which is fixed at a 6% pa, broadly reflecting historical values of the cost of capital. The issue is that the current rate of return is variable and therefore the modification proposal seeks to address that issue.

The purpose of the modification proposal is to align the rate of return (applied to the asset value of connection points in the calculation of annual connection charges) to the pre-tax cost of capital in the price control of the relevant Transmission Owner ("TO").

The modification proposal CMP306

On 28 September 2018, CMP306 was proposed by Northern Powergrid and was submitted to the CUSC Modifications Panel⁴ for its consideration. CMP306 aims to amend section 14.3.21 of the CUSC by changing the annual connection charge rate of return to the price control cost of capital. Paragraph 14.3.21 of the current CUSC Connection Charging Methodology calculates the capital component of the annual connection charge by applying an out of date return element of 6% for assets indexed using the Retail Price Indices ("RPI"), or 7.5% for assets under the Modern Equivalent Asset ("MEA") revaluation.

¹ References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

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

³ <https://www.nationalgrideso.com/industry-information/charging/connection-charges>.

⁴ The CUSC Panel is established and constituted from time to time pursuant to and in accordance with section 8 of the CUSC.

As set out at transmission standard licence condition C6.8, the connection charging methodology should allow the relevant TO to recover (a) its costs of carrying out any works and (b) a reasonable rate of return on the capital represented by such costs. In effect, the charges should be cost-reflective.

The current 6% RPI linked return was previously a reasonable assessment of the cost of capital of the relevant TO, as it was aligned with a price control assessment of the cost of capital. However, the figure has not been updated to reflect more recent cost of capital determinations by Ofgem. The 6% figure for an RPI linked return is therefore no longer reflective of the cost of capital of the relevant TOs, and is therefore no longer a reasonable rate of return on the costs incurred by the TOs.

The proposal only relates to underlying cost of capital used in calculating the appropriate rate of return. It does not consider the appropriate difference between the return on RPI-linked and MEA-linked assets (which is currently set at 1.5 percentage points).

CUSC Panel recommendation

On 25 October 2019, the CUSC Panel voted on CMP306 against the Applicable CUSC Charging Objectives as set out in Standard Condition C5 of the Electricity Transmission Licence⁵. All members of the Workgroup voted that the Original Proposal better facilitated the Applicable CUSC objectives in comparison with the existing baseline.

Our decision

On 14 November 2019, the modification proposal and the Final Modification Report ("FMR")⁶ was published. We have considered the issues raised in the FMR and we have taken into account the responses to the industry consultations on the modification proposal which are attached to the FMR⁷. We have concluded that:

- implementation of the modification proposal will better facilitate the achievement of the applicable charging objectives of the CUSC;⁸ and
- directing that the modification be made is consistent with our principal objective and statutory duties.⁹

⁵ As set out in Standard Condition C5 of the Electricity Transmission Licence, see: <https://epr.ofgem.gov.uk//Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf>

⁶ <https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc-old/modifications/cmp306-align>

⁷ <https://www.nationalgrideso.com/codes/connection-and-use-system-code-cusc/modifications/cmp306-align-annual-connection-charge-rate>.

⁸ As set out in Standard Condition C5 of the Electricity Transmission Licence, see: <https://epr.ofgem.gov.uk//Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf>.

⁹ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989 as amended.

Reasons for our decision

We consider this modification proposal will better facilitate the CUSC charging objectives (b) and (c) as set out in Standard Licence Condition C5: Use of system charging methodology, and has a neutral impact on the other applicable CUSC charging objectives (a), (d) and (e)¹⁰:

(b) results in charges which reflect, as far as is reasonably practicable, the costs incurred by transmission licensees in their transmission businesses and which are compatible with standard licence condition C26 (requirements of a connect and manage connection);

Aligning the rate of return applied in connection charges to the pre-tax cost of capital in the relevant TO's price control will result in improved cost reflectivity for connection charging.

(c) That, so far as is consistent with sub-paragraphs (a) and (b), the use of system charging methodology, as far as is reasonably practicable, properly takes account of the developments in transmission licensees' transmission businesses;

This proposal will ensure the rate of return aligns to the price control cost of capital and thus reflect changes in subsequent price controls.

Decision notice

In accordance with Standard Condition C10 of the Transmission Licence, the Authority, hereby directs that modification proposal CMP306: "Align annual connection charge rate of return at CUSC 14.3.21 to price control cost of capital" be made.



Steven McMahon

Deputy Director, Systems and Networks

Signed on behalf of the Authority and authorised for that purpose

¹⁰ As set out in Standard Condition C5 of the Electricity Transmission Licence, see: <https://epr.ofgem.gov.uk//Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf>