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## STANDARD CONDITION 4 OF THE GAS TRANSPORTERS (GT) LICENCE

### GT CHARGING METHODOLOGY

#### 1. INTRODUCTION

BGCL levies transportation charges pursuant to Standard Condition 4 of the Gas Transporters Licence ("Condition 4 Charges").

This methodology describes the methods and principles employed by BGCL to derive its Condition 4 transportation charges.

It is BGCL's intention to set charges using this methodology to recover the capital costs for all sites won by BGCL from 1<sup>st</sup> December 2002, and a limited number of sites won prior to that date.

Pursuant to the Gas Transporters licence, and consistent with the competitive environment in pipeline connections and system extensions, BGCL seeks to minimise transportation charges where possible by employing economic purchasing approaches.

#### 2. GENERAL APPROACH TO DERIVING THE CHARGES

In order to derive this methodology BGCL has undertaken the following processes:

- a detailed listing and quantification of operating and engineering costs (in some cases, based on best forecasts);
- an analysis of the cost items and the determination of cost-drivers giving rise to them;
- allocation of cost items between Operating and Capital expenditure ;
- financial and economic analysis to calculate appropriate charges to recover costs over assumed timeframes, taking account of the minimum hurdle rate the business requires for such investment and the cost of capital employed to achieve a reasonable profit.

In order to calculate the Capacity Charge component of its transportation charges BGCL utilises a specific business model developed for this purpose. The model calculates the net present value of the investment, setting the NPV to zero based on revenues, costs and profit. Charges are set taking account of the forecast revenue streams, forecast contracted costs and timescales of network construction, prevailing benchmark transportation charges (which are used by BGCL to assess whether

charges are reasonable in the circumstances) and the reasonable profit required by the business.

### 3. THE OPERATING CHARGE

#### 3.1 COSTS - GENERAL

The Operating Charge is set to recover the following costs:

- all day to day operating and business costs;
- anticipated costs for provision of emergency services and call-outs;
- costs associated with maintaining medium pressure equipment;
- costs incurred due to the estimation of opening meter readings;
- costs of network maintenance and any associated asset replacement works.

Appendix 1 lists the main cost categories allocated for cost recovery via the Operating Charge.

(On-going) Operating Costs are the day to day costs of running and operating the BGCL business and include the costs of staff, office, business set-up and equipment.

A single fixed Daily charge per Supply Point (irrespective of Site) is levied for the recovery of Operating Costs. The charge is a weighted average charge, based on forecasts of costs and Supply Point connections over a 10-year period. Thus, the charge is smoothed over the 10-year period and avoids high charges in the earliest years.

Consistent with obligations set out in Standard Condition 4A of its licence, BGCL periodically reviews the charge and, if it considers it appropriate and reasonable, will revise the charge upwards or downwards in the light of changing forecast assumptions and actual revenues received in accordance with the relevant objectives.

In accordance with normal accounting practice any write down required as a result of asset re-evaluation, including obsolescence, will be treated as a revenue expense at the time of re-evaluation.

#### 3.2 CHARGES IN RESPECT OF MAINTAINING MEDIUM PRESSURE EQUIPMENT

The "Medium Pressure Charge" is set to recover those on-going costs associated primarily with the maintenance, and inspection of medium pressure governors installed and owned by BGCL.

The Medium Pressure Charge applies to those sites for which on-going medium pressure costs arise. For these sites, the same fixed pence per supply point per day

charge is made, derived in the same way as for the Operating Charge, i.e. based on forecast costs and supply point connections over a 10-year period.

### 3.3 CHARGES FOR THE PROVISION OF ESTIMATED OPENING METER READINGS (EOMR)

British Gas Connections implemented the EOMR Charge, from 1 August 2002. The charge is applied to recover the cost of generating and providing estimated opening meter readings as part of the supply point transfer process. Estimates are required where confirming shippers fail to provide opening meter readings to BGCL within a prescribed timeframe and the confirming shippers who give rise to this have the charge levied on them.

The charge was implemented following a formal process to modify BGCL's Condition 4 charging methodology in accordance with the GT licence. Following the formal consultation on the proposal with shippers and discussions and agreement with the Authority, a charge of £10 per estimate is applied.

BGCL will review the level of the EOMR charge at six monthly intervals. If it is found that the EOMR charge is not reasonable or cost reflective, in relation to the EOMR service, BGCL shall ensure that any revisions to the methodology (and subsequent charges) shall include a rebate. This rebate will be made to all affected shippers, to return the difference between the charges levied and any reduced Operating Charge or EOMR charge that should have been applied.

### 3.4 IMPLEMENTATION

The "Operating Charge" is a single charge applying to each Supply Point connected to any BGCL system (subject to the terms and conditions of BGCL's Network Code).

The Medium Pressure Charge is a single charge applying to each Supply Point connected to a BGCL system to which medium pressure costs apply.

The Opening Meter Reading Estimate Charge is applied to each estimate BGCL makes pursuant to the network code as part of the supply point transfer process. The charge is payable by Confirming Shippers that fail to provide an Opening Meter Reading to BGCL within the timeframe allowed within the network code.

## 4. THE CAPACITY CHARGE

### 4.1 COSTS - GENERAL

Capacity Charges are set to recover all costs referable in whole or in part to the laying of pipes for the purpose of conveying gas to premises. They are set on a site by site basis, recognising that different site characteristics (size, location, ground conditions, composition of Supply Points, etc.) result in different levels of costs (for individual cost items).

It is BGCL's intention to recover costs associated with constructing new gas networks using this methodology for all sites won by BGCL from the 1<sup>st</sup> December 2002, and for a limited number of sites won prior to that date.

In order to calculate the Capacity Charge component of its transportation charges BGCL utilises a specific business model developed for this purpose. The model calculates the net present value of the investment, setting the NPV to zero based on revenues, costs and profit. Charges are set taking account of the forecast revenue streams, forecast contracted costs and timescales of network construction, prevailing benchmark transportation charges (which are used by BGCL assess whether charges are reasonable in the circumstances) and the reasonable profit required by the business.

BGCL competes with other GTs to win contracts for network provision, therefore its contracted costs, business model, and assumptions are commercially confidential. The relevant cost and revenue information and business model for each site is however available to Ofgem on reasonable request and retained by BGCL for this purpose.

The costs are allocated to 2 different cost-drivers: those, which are a function of the number of premises (or Supply Points) on a Site; and those, which are a function of the number of houses per expected consumption band.

Without prejudice to section 4.5, BGCL will seek to recover all costs, and earn a reasonable profit, over a target period of 20 years.

#### 4.2 SERVICE CHARGE COMPONENT

The "Service Charge Component" is in respect of all costs attributed to Supply Points, irrespective of size or type. The main cost-drivers giving rise to the Service Charge Component are listed in Appendix 2.

Therefore, for a particular site, the Service Charge Component of the Capacity Charge will be a single fixed charge per domestic Supply Point per Day.

The Service Charge Component for non-domestic premises are considered on a case by case basis.

Where BGCL provides a meter the cost of this will be included in the Service Charge Component. Where a meter is provided by a third party, BGCL will reflect this in a reduced Service Charge Component. For the avoidance of doubt, where BGCL charges for the provision of a meter and the meter is subsequently replaced (and returned in good order) by an owner other than BGCL, BGCL will reduce the amount payable by way of transportation charges by the relevant shipper.

#### 4.3 DISTRIBUTION CHARGE COMPONENT

The "Distribution Charge Component" is in respect of the provision and laying of distribution mains to a site. It is a function of the number of Supply Points to be connected to the site and the distribution of these Supply Points across a range of

annual consumption bands. This reflects the assumptions used in sizing the distribution mains and is a mechanism for allocating distribution capacity to different Supply Points (according to their "design consumption"). The main cost-drivers giving rise to the Distribution Charge Component are listed in Appendix 2. The consumption bands (in kWh) are as follows:

0 – 14,654; 14,655 – 29,307; 29,308 – 43,961; 43,962 – 73,268.

The equivalent bands in therms are approximately:

0 – 500; 501 – 1000; 1001 – 1500; 1501 – 2500.

Therefore, for each consumption band, there will be a single fixed charge per Supply Point per day.

BGCL may choose to further categorise non-domestic premises should it seem reasonable for it to do so (for example, where there is a very wide range of non-domestic annual consumptions it may be appropriate to allocate these premises to bands which relate to different load factors), and shall advise relevant shippers and Ofgem accordingly.

The allocation of a Supply Point to a consumption band reflects the expected Annual Quantity (AQ) of the Supply Point, consistent with engineering design criteria. Once allocated to a consumption band, a Supply Point may not usually transfer to another. However, in exceptional circumstances BGCL may, upon the request of the Registered User and at BGCL's sole discretion, allow a Supply Point to transfer to another consumption band where it is demonstrably clear that the actual AQ of the Supply Point has been persistently (i.e. for at least the past 18 months) and significantly different (i.e. is at least 20% higher than the lower bound of the next highest band or 20% lower than the upper bound of the next lowest band) from the initial estimate provided by the first Registered User. Any such change may precipitate a rebalancing of transportation charges among the annual consumption bands and will be subject to periodic review by BGCL.

Appendix 3 provides a copy of BGCL's current table of the Design Annual Quantities by property type which is used as the basis to design and construct BGCL's networks. This table is provided for reference purposes only and does not form part of the methodology statement, therefore acting as a Reasonable and Prudent Operator (RPO) BGCL reserves the right to update the table from time to time. BGCL shall advise relevant shippers and Ofgem of any material revisions to the table in writing within 28 days of the implementation date of the revised table.

#### 4.4 SETTING OF SMOOTHED CHARGES

BGCL recovers its costs via Capacity Charges in a smoothed manner over a set timeframe (in this case, initially 20 years per supply point). Initial charges will be based on forecast costs and a forecast profile of how a site will be developed over the period, the intention being that charges for a Supply Point should not vary

significantly from year to year and that the earliest Supply Points connected should not bear unduly high charges.

#### 4.5 RISK

BGCL endeavours to set charges on the basis of accurate forecasts. BGCL does not seek to benefit, but does want to avoid being unreasonably penalised, when forecasts, made by a sound method, prove inaccurate. BGCL may periodically adjust its charges to reflect deviations from target revenues. In particular, adjustments might be sought where:

- (a) the forecast number of Supply Points is inaccurate;
- (b) the forecast profile of Supply Point connections is inaccurate.

BGCL may, subject to approval from the Authority and to minimum notice periods pursuant to the GT Licence, adjust its charges upwards or downwards where appropriate to recover any cost changes resulting from deviations from forecast trends. Additionally, BGCL may similarly seek to extend its cost-recovery period for the recovery of capital related costs via capacity charges by up to 5 years, to a total of up to 25 years.

As stated above, any changes to BGCL's charges would be subject to approval by the Authority. However, where the Authority permits, BGCL will make limited adjustments without seeking approval.

Where practicable and economically justifiable, BGCL may take other reasonable measures to mitigate business risk. Such measures might include taking out insurance with a third party, risk-sharing contracts with building developers or self-insurance via a small premium to transportation charges (or a combination of these).

#### 4.6 IMPLEMENTATION

The "Capacity Charge" is a single charge per annual consumption band applying to each Supply Point connected to a BGCL system (subject to the terms and conditions of BGCL's Network Code); i.e. the Capacity Charge will be the sum of the Service Charge Component and the Distribution Charge Component.

### 5. FIXED CHARGE METHODOLOGY

BGCL applies a pure fixed charging approach. The Distribution Charge Component recognises annual consumption in setting differential charges for different expected consumption levels and is, in effect, an approximation to a variable-type charge.

Summary of Costs Allocated to the Operating Charge

The following generic costs will be recovered from BRITISH GAS CONNECTIONS LIMITED's Operating Charge:

Business Start-Up

Salaries

Business Rates

Costs of network maintenance and any associated asset replacement works

Travel and Subsistence

Office Costs

Facilities

Sales and Marketing

Gas Transporter Licence Fees

Bank Charges

Legal and Professional Fees

Audit Fees

Subscriptions and Donations

Site-related Costs (incl. on-going emergency services; call-outs, etc.)

Financial Costs

Corporate Centre Charge

Obsolete Assets

APPENDIX 2Service Costs comprise the following items:

Service Pipes and Installation

Service Connection (Commissioning/ Testing)

Meter Connection (Meter plus fixing kit, Meter box, Installation, Storage)

Site Works Supervision (including quality assurance)

Ofgem Licence Extension fees and statutory notices

Site Set up Charges where applicable (e.g. Emergency Cover)

Distribution Costs comprise the following items:

Distribution Mains and Installation

Transco Connection Charge

Commissioning and Testing

Project Management and Design

Wayleaves



**BRITISH GAS CONNECTIONS**  
**DESIGN AQ's IN KWhs BY STANDARD PROPERTY TYPE**  
**DECEMBER 2002**

**AQ (KWhs) House Type**

5800	Bedsit
8100	1Bedroom Flat
9900	1Bedroom Semi Detached Bungalow
10800	2Bedroom Flat
12100	2Bedroom Terraced House
13500	2Bedroom Semi-Detached Bungalow
14800	3Bedroom Terraced House
15300	2Bedroom Semi-Detached House & 2Bedroom Bungalow
17100	2Bedroom Detached House
17500	4Bedroom Terraced House
18000	3Bedroom Semi-Detached House & 3Bedroom Detached Bungalow & 4Bedroom Semi- Detached bungalow
19300	3Bedroom Detached House
20700	4Bedroom Semi-Detached House
21600	4Bedroom Detached Bungalow
23400	4Bedroom Detached House
26100	5Bedroom Detached House
29100	6Bedroom Detached House