



Chris Bennett
Regulatory Frameworks Manager
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

*Promoting choice and
value for all customers*

Direct Dial: 020 7901 7050
Email: robert.hull@ofgem.gov.uk

Date: 19 December 2007

Dear Chris,

GBEMC-09: Charging arrangements associated with SQSS design variations based on customer requests

Thank you for your letter dated 14 December 2007 informing us of National Grid's intention not to submit, for implementation by 1 April 2008, any of the use of system charging methodology modification proposals that had been consulted on under GBEMC-09 "Charging arrangements associated with Security and Quality of Supply Standard ("SQSS") design variations based on customer requests". In that letter, you also set out National Grid's minded-to approach to developing an enduring and complete solution by summer 2008 to provide more cost reflective and consistent charging arrangements for SQSS connection design variations.

This letter sets out Ofgem's views on this matter and our expectations of National Grid's role in delivering this work for implementation from 1 April 2009.

The issue

The SQSS sets out the deterministic criteria for the design of generation connections to the transmission network. It also allows variations from the normal connection design meeting those deterministic criteria, provided that it is requested by the generator and that the variations do not adversely affect other customers in terms of cost or quality of supply. Typically, this means that a lower-security connection design, e.g. a single circuit instead of double circuit connection, leads to uncompensated access restrictions associated with loss of assets in the relevant local connection infrastructure. A generator's choice on the connection design is expected to be based on its trade-off between the risk of lower security without compensation and lower capital costs for connection.

The change introduced with "plugs" transferred a substantial proportion of the costs associated with the local transmission assets from Connection charges recovered directly from individual users to the Transmission Network Use of System ("TNUoS") charges recovered from all users of the GB transmission system.

Given the various features of the TNUoS charging methodology including zonal averaging of long run incremental transmission costs and the sharing ratio of 27:73 between generation and demand users, there is no direct reflection in an individual generator's TNUoS charges of the capital savings associated with a lower security connection design. The consequence is that the capital cost incentive for a generator to choose a less costly connection with a lower level of security is much weakened. The reduced incentive has the impact of distorting the choice being made by generators and results in the building of more transmission assets than would have otherwise been required were the generator faced the full cost signals associated with the connection design.

The problem is most acute in Scotland, where many small generators are seeking to connect to the transmission system at 132kV. Whilst a single circuit connection would have been the normally expected connection design, and would have been expected to be a generator's choice under the pre-BETTA "deep" connection charging regime, few generators are making such a choice under the existing TNUoS charging methodology.

Development of National Grid's charging modification proposals

In December 2005, as a result of parties expressing concerns to Ofgem, we wrote to National Grid¹ requesting that it review the existing transmission charging methodologies with a view to considering whether the existing arrangements should be revised to reflect the interaction with the SQSS and thus to promote the most efficient choice of connection design.

On 17 November 2006, National Grid submitted a conclusions report² to the Authority recommending that the TNUoS charging methodology be modified to introduce a discount to the TNUoS charges of users who chose to connect via single circuit connections. The proposed modification put forward by National Grid involved the introduction of one discount mechanism comprising a circuit element and a substation element.

In December 2006, Ofgem published an Impact Assessment³ to seek further views from interested parties on the issues raised and on the impact of the proposed change.

The Authority published its decision to veto National Grid's proposed charging modification on 16 February 2007⁴. In setting out the reasons for its decision, the Authority noted that while there was strong support for the general principle of introducing a TNUoS charge discount to generators who connect via less secure connections, there were sufficiently material issues raised by respondents on the size and cost reflectivity of the proposed circuit discount mechanism that must be further addressed. In particular it was felt that the proposed circuit discount mechanism appeared to be significantly conservative when compared to the actual costs that could be saved by building a single circuit instead of a double circuit connection. As a result, we had concerns that the proposed discount mechanism did not result in a cost-reflective reduction to the TNUoS charge. It was felt that this would be to the detriment of consumers, as it would result in higher than necessary levels of transmission infrastructure, the costs of which would ultimately be borne by them.

On 2 November 2007, National Grid published a consultation document⁵ setting out a range of options, for potential implementation from 1 April 2008, for charging arrangements for the single circuit, substation and partial redundancy aspects of design variation connections. National Grid's preferred option was to introduce a discount mechanism comprising a generic circuit discount to the TNUoS charge and no substation discount element. Whilst this option was potentially the least reflective of the cost savings, National Grid noted that it would be most consistent with the way the TNUoS tariffs are derived and hence would avoid inappropriate incentives which National Grid believed to exist in other more cost-reflective options.

In addition to considering written responses to its consultation, National Grid also held discussion and presented their further thoughts on potential charging modifications at the December 2007 meeting of the Transmission Charging Methodology Forum. Upon review of the industry responses, including the concerns raised by respondents to all the options consulted upon so far, National Grid is now of the view that there is a genuine enduring solution that will achieve cost reflectivity and avoid inappropriate incentives.

¹ Letter to Stuart Easterbrook from Robert Hull, published on 9 December 2005. Available from the Ofgem website; www.ofgem.gov.uk

² Available from NGET's website: <http://www.nationalgrid.com/NR/rndonlyres/ED88CECC-7B6C-44AB-9020-345BF4E17FB4/12859/GBECM06ConclusionsReport.pdf>

³ Available from the Ofgem website: http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Documents1/16499-215_06.pdf

⁴ Available from NGET's website: <http://www.nationalgrid.com/NR/rndonlyres/491F2854-660F-462C-9E0D-BAF41A8B7D7A/15284/GBECM06AuthorityDecisionLetter.pdf>

⁵ Available from NGET's website: <http://www.nationalgrid.com/NR/rndonlyres/OCA66A3C-2D04-47FD-A6DB-BC7D1E80DC9D/21148/GBECM09DesignVariationDiscount.pdf>

National Grid acknowledges that this alternative approach will require further analysis and consultation with industry and will not be possible for implementation by 1 April 2008. Instead, it proposes to start industry discussions on alternative approaches in January 2008 and issue a pre-consultation paper soon afterwards. In its view, this will allow a formal consultation on final proposals, to be followed with a report of final proposals to the Authority for approval in summer 2008.

Ofgem's view on the way forward

Ofgem notes the views of National Grid and the majority of the respondents to its consultation that each of the options consulted upon so far as part of GBECM-09 would have serious shortcomings in terms of either lack of cost-reflectivity or inappropriate interaction with the TNUoS tariffs. We also note the views of National Grid and the majority of the respondents that there is a real prospect of an enduring solution which would avoid both problems, but which will need to be developed more fully and consulted upon within the industry.

It is disappointing that only limited progress has been made on this important issue since our first request for review in December 2005. Despite the effort made by National Grid and industry, we are concerned that there has been a lack of focus on the key issues, especially after the veto decision by the Authority in February 2006. Further, we are not convinced of some of the detailed arguments made by National Grid, for example, the potential distortion to the locational signals resulting from substation discount. However, we do recognise some other issues raised so far, in particular, the potential undesirable interaction between the setting of charges and discounts relating to the same connection line. We also recognise the need for an enduring solution to be developed and subject to full industry consultation. Therefore we agree that instead of proposing partial modifications for implementation from 1 April 2008, the more appropriate approach is to develop the enduring solution in the next few months.

We note National Grid's comment that a relatively small number of connectees will make a decision regarding security in 2008/9. However, we also note that given the significant volume of renewable generation seeking connection to the transmission system after that period, there is an increasingly urgent need to improve the cost-reflectivity of the TNUoS charges for generators to perform effective assessment of alternative connection designs and make the most economic and efficient choice. Given the substantial time already spent within the industry on debating the detailed aspects and points of some of the common features of potential changes, we expect the follow-on work to concentrate on new issues and be focused on the delivery of an appropriate solution.

We welcome National Grid's commitment to deliver an enduring solution by summer 2008 and, subject to the Authority's approval, expect that National Grid will be in the position to implement the solution no later than 1 April 2009. Given the importance of the issue and to help keep the momentum of the work, we will request National Grid to set out a more detailed timetable for achieving this and provide regular reports to Ofgem detailing the progress against key milestones.

Please do not hesitate to get in touch should you require any more information on this issue.

Yours sincerely



Robert Hull
Director, Transmission