Promoting choice and value for all gas and electricity customers

Amendment proposal:	**Connection and Use of System Code (CUSC) CAP170: System to generator operational intertripping scheme**		
Decision:	The Authority[1] directs that the proposed change to the CUSC[2] is not made		
Target audience:	National Grid Electricity Transmission PLC (NGET), Parties to the CUSC and other interested parties		
Date of publication:	5 November 2010	Implementation Date:	N/A

Background to the amendment proposal

Ofgem has longstanding concerns about the increasing level of constraints costs on the transmission system. The costs of constraints have increased from £70m in 2007/08 to £139m in 2009/10. NGET is forecasting costs of £239m for the year 2010/11. Going forward, analysis carried out by NGET and separately by Frontier Economics has indicated scope for much higher future constraint costs[3].

On 17 February 2009, we wrote an open letter[4] to NGET expressing concerns about the current and forecast levels of constraint costs. Our letter asked NGET to conduct an urgent review to consider (and if appropriate consult on) whether urgent changes to the existing commercial and charging arrangements for transmission access are necessary to manage more effectively the costs of constraints, and to ensure that any constraints costs are recovered on an equitable basis from customers, suppliers and generators.

NGET raised CAP170 as an 'Urgent' CUSC Amendment Proposal[5] in February 2009, as one of the measures it had identified to seek to address the issues Ofgem raised in its open letter[6]. CAP170 was proposed as an interim measure until enduring access reforms were implemented.

In July 2009, the Secretary of State indicated his intention to use the Energy Act 2008 powers to bring about enduring access reform[7]. The Secretary of State subsequently published consultations, in August 2009 and in March 2010, on 'Improving Grid Access'[8].

On 11 August 2010, the Secretary of State exercised his powers under section 84 of the Energy Act 2010 to implement a form of Connect and Manage[9]. The Secretary of State also made clear that the costs of constraints would be charged back to users of the

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.
[3] http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TAR/Documents1/Frontier_CM_Constraints.pdf
[4] http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/20090217Managing%20constraints.pdf
[5] In accordance with the process set out in CUSC Section 8.21.
[6] NGET also raised a proposal to amend its charging methodology - GB ECM-18 – Locational BSUoS. Our decision on that proposal is available on our website: http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Documents1/GB_ECM-18_Decision_letter.pdf
[7] DECC (2009): 'The Low Carbon Transition Plan': http://decc.gov.uk/assets/decc/white%20papers/uk%20low%20carbon%20transition%20plan%20wp09/1_20090724153238_e_@@_lowcarbontransitionplan.pdf
[8] DECC's consultations and decision on 'Improving Grid Access can be viewed at the following link: http://www.decc.gov.uk/en/content/cms/consultations/improving_grid/improving_grid.aspx
[9] Section 84 was commenced on 29 July 2010 by the Energy Act 2008 (Commencement No 5) Order 2010 [SI 2010 No 1888], with an effective date of 11 August 2010.

system on a smeared per MWh basis. These provisions have been reflected in the transmission licence, the CUSC and other industry codes.

The amendment proposal

CAP170 proposes a new category of administered price intertrip service, to be applied to generators located behind any derogated transmission boundary[10] in GB. An intertrip is a mechanism that can automatically reduce or disconnect the electricity a generator is putting onto the transmission system. It is one of the tools that NGET can use to help manage constraints on the transmission system.

The administered price proposed under CAP170 would remunerate affected generators in line with the administered pricing arrangements that currently apply to other categories of intertripping schemes. These prices were introduced by a previous CUSC amendment approved by the Authority in June 2005, CAP076[11], and the level of payment introduced was one of the options proposed by the CAP076 working group. This payment includes:

- an annual *'Capability Payment'* (around £33,000 per annum[12]) for the installation and right to arm the scheme, covering costs such as additional staff training, upkeep of policies and procedures
- an '*Intertrip Payment'* (around £444,000 per generating unit per trip[13]), covering costs of wear and tear following a trip as well as additional fuel costs
- a '*Restricted Export Level Payment'* (£/MW/day) following tripping, should NGET be unable to restore the transmission capacity within 24 hours following the trip – this is intended to rebate Transmission Network Use of System (TNUoS) charges on a daily basis (if capacity is not available after 24 hours), in accordance with the standard payments for disconnections under the CUSC.

Under CAP170, NGET would in the first instance seek to replace existing agreements with administered price arrangements as set out above for intertrip behind the existing derogated boundary. The existing derogated boundary is the Cheviot boundary between Scotland and England, although as noted above, the proposal could be applied to any derogated boundary in GB.

NGET has identified a number of consequential changes to industry documents that would be required if CAP170 were to be approved, namely amendments to the Grid Code and to NGET's Balancing Principles Statement (BPS) and Procurement Guidelines (PGs). The Grid Code change would introduce a new definition of "Category 5 intertripping scheme" into the Grid Code, in addition to the existing four categories already defined. We have issued our decision on the proposed Grid Code change separately[14]. The proposed changes to the BPS and PGs seek to clarify the circumstances in which NGET may seek to use a category 5 intertripping scheme, and the criteria it would consider

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[10] A derogated boundary is one for which derogation from the obligation to comply with the National Electricity Transmission System Security and Quality of Supply Standard (NETS SQSS) is in place. In this case, derogation facilitates the connection of generation behind the boundary in advance of reinforcement.

[11] Further information on CAP076 including the Authority's decision can be viewed in the 'Archive Amendments Area' of NGET's website at the following link: http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/amendment_archive/

[12] CUSC section 4, Schedule 4 sets out that the Capability Payment is £1.72 per settlement period. This figure is specified at April 2005 base, and is subject to indexation in accordance with paragraph 4.5 of the CUSC. The indexation rate for 09/10 is 1.1092 which gives a payment rate of £1.91 per Settlement Period (correct to two decimal places). £1.91 x 17520 Settlement Periods per year = £33,463.20.

[13] CUSC specifies a figure of £400,000. As above, using indexation rate for 2009/10, £400,000 x 1.1092 = £443,680.

[14] http://www.ofgem.gov.uk/Licensing/ElecCodes/GridCode/Mods/Pages/Mods.aspx

when identifying which generators it would seek to procure this service from. The Authority is not required to make a decision on these changes, as these have not proceeded to final reports[15].

NGET considers that CAP170 will better facilitate the applicable CUSC objectives[16] as it considers that it would provide the potential for NGET to manage constraints in a more efficient and effective manner.

CUSC Panel[17] recommendation

On 27 February 2009, the CUSC Panel recommended that CAP170 be treated as an Urgent Amendment Proposal[18]. On 2 March 2009, we wrote to the CUSC Panel indicating that Ofgem agreed with the CUSC Panel recommendation[19].

CAP170 was submitted directly to industry consultation on 3 March 2009, and was discussed by the CUSC Panel at its meeting of 23 March 2009. The Panel recommended by majority that the Authority should reject CAP170. We received the final Amendment Report for CAP170 on 25 March 2009[20].

Impact assessment, additional consultation and analysis

On 21 May 2009, Ofgem issued an impact assessment on CAP170[21]. This assessment sought views on the quantitative and qualitative analysis of the impacts of CAP170. The assessment set out that CAP170 was intended to be an interim measure that would last only until enduring access reforms were in place. We noted that CAP170 might be expected to have a positive impact, by reducing the operating costs that could otherwise fall to consumers – by on average £40m per annum. We also discussed competition issues that we considered to be relevant to our assessment of CAP170, in particular our concerns that competition may not be effective in limiting the prices NGET pays for balancing services (including intertrip) behind the Cheviot boundary.

NGET stated in its response to our impact assessment that it expected smaller cost savings for the period 2009/10 than it had previously forecasted. In response to this,

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[15] On 19 May 2009, the Authority issued a Direction pursuant to SLC C16(8), directing NGET not to submit reports on the changes proposed to the BPS and PGs (as a consequence of CAP170) in the timescales set out in SLC C16. The Direction set out that this was to enable the Authority to make a decision on all the related changes in similar timescales. As the Authority is now rejecting CAP170, we do not consider it is necessary to direct NGET to submit reports to the Authority on the BPS and PG changes, as these are not required in the absence of CAP170. The 19 May 2009 Direction is available on our ePR: http://epr.ofgem.gov.uk/document_fetch.php?documentid=14416

[16] As set out in Standard Condition C10(1) (a) and (b) of NGET's Transmission Licence.

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

[18] The CUSC includes procedures to allow the CUSC Panel and the Authority to consider Amendment Proposals under expedited timescales (the Urgent Amendment process - CUSC section 8.21). The Panel provides a recommendation to the Authority on whether an Amendment Proposal should be considered as Urgent and also a recommended timetable that should be followed. The request for urgency can be viewed at the following link: http://www.nationalgrid.com/NR/rdonlyres/0581ACB7-75AD-4A9E-9FBB-174879600310/35802/CAP170RequestforUrgencyIntertrips.pdf

[19] http://www.nationalgrid.com/NR/rdonlyres/075D3EF7-0FE8-4CFF-8ECB-0A14CCE0B2E9/32386/CAP170UD.PDF

[20] http://www.nationalgrid.com/NR/rdonlyres/75F5B49C-B6CF-4CD4-B351-AFC64A059896/33030/FinalCAP170ARVolume1v10.pdf and http://www.nationalgrid.com/NR/rdonlyres/E9E2753E-DC5F-41EF-AD38-97A00677A95E/33029/FinalCAP170ARVolume2v10.pdf

[21] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=090521CAP170IA.pdf&refer=Licensing/ElecCodes/CUSC/Ias

Ofgem issued in July 2009 a further consultation[22] on potential costs savings under CAP170. In light of the responses to both consultations, in January 2010, we issued a consultation[23] on the competition issues that we consider to be relevant to our assessment of CAP170.

Following this further consultation, Ofgem issued a number of formal information requests[24] to NGET and a number of generation licensees in GB. The purpose of these requests was to seek additional information to inform our assessment of CAP170. We asked for information on NGET's contracting strategy for procuring intertrip services in GB, latest details of the existing contractual arrangements NGET currently has in place with generators for intertrip, and information on the costs generators take into account when offering a price to NGET for this service under the existing commercial arrangements[25].

Respondents' views

Full copies of the non-confidential responses to our consultations are available on Ofgem's website[26]. The majority of respondents did not support the proposal. Several agreed that the issue of high constraints costs must be addressed, but did not consider that CAP170 was the right solution. Some respondents considered the enforcement of competition law to be a more appropriate means to address the market power issues relevant to CAP170. Some respondents considered that the case had not been made to replace an existing market mechanism with an administered solution, or to enable NGET to introduce changes to existing connection agreements in the manner proposed. Respondents were also concerned that the urgent CUSC process meant there was insufficient time for industry to fully consider the proposal, or to bring forward alternatives. Some respondents were also concerned that the administered price CAP170 would introduce would not sufficiently remunerate generators for providing the service.

The Authority's decision

The Authority has considered the issues raised by the amendment proposal and the final Amendment Report (AR) dated 25 March 2009. The Authority has considered and taken into account the responses to NGET's consultation on the amendment proposal which are attached to the AR[27] and responses to the impact assessment, consultations and information requests carried out by Ofgem.

The Authority has concluded that implementation of the amendment proposal will not overall better facilitate the achievement of the applicable objectives of the CUSC[28]. Accordingly, the Authority has decided to reject the CAP170 proposal.

[22] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=78&refer=Licensing/ElecCodes/CUSC/Ias
[23] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=95&refer=Licensing/ElecCodes/CUSC/Ias
[24] Using our powers under SLC B4 of the electricity transmission licence and SLC 13 of the electricity generation licence.
[25] The responses licensees provided to our information requests contain commercially sensitive information so are not published.
[26] See links at footnotes 20–22.
[27] CUSC amendment proposals, amendment reports and representations can be viewed on the NGET website at http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/
[28] As set out in Standard Condition C10(1) of NGET's Transmission Licence, see page 165: http://epr.ofgem.gov.uk/document_fetch.php?documentid=15184

Reasons for the Authority's decision

Assessment against applicable objective (a) – efficient discharge of obligations under the Act and licence

NGET is required under Section 9(2) of the Electricity Act 1989 "to develop and maintain an efficient, co-ordinated and economical system of electricity transmission". Under standard licence condition C16 "Procurement and use of balancing services" ('SLC C16')[29], NGET is obliged to co-ordinate and direct the flow of electricity onto and over the electricity transmission system in an efficient, economic and co-ordinated manner".

The analysis in our impact assessment indicated cost savings associated with CAP170 of on average approximately £40m per annum. NGET set out in its response to our impact assessment that it expected smaller cost savings in the period 2009/10 than set out in our impact assessment. Smaller costs savings would arise as a result of (i) the 'price effect': NGET negotiated less expensive contracts for the summer 2009 outage period; and (ii) the 'volume' effect: the later into the summer outage period that the proposal would be implemented, the smaller the volume of constraints that it would apply to. NGET's latest forecast of cost savings under CAP170 is in the range of £14-18m[30] for the period 2010/11.

The costs savings under CAP170 arise by replacing the costs that would be incurred under existing commercial agreements behind the single derogated boundary (Cheviot), with the administered price proposed under CAP170.

As discussed in our February 2009 open letter and in our impact assessment, we have concerns about the increasing constraints costs on the transmission system, and therefore recognise the positive impact CAP170 could have in helping to reduce costs that could ultimately fall to consumers. As also discussed in our impact assessment and subsequent consultations on the proposal, CAP170 would introduce a price that already applies to administered categories of intertrip, and no one has so far proposed an alternative price.

However, we also note that several respondents consider that the price proposed under CAP170 would not appropriately remunerate generators in the circumstances in which intertrip would be provided under this proposal. Notwithstanding concerns being raised by respondents, no one has so far proposed an alternative price.

We recognise the benefit that the proposal could introduce, and consider this indicates that the proposal may better facilitate applicable objective (a) by reducing costs that could otherwise fall to consumers. Whilst we would welcome this potential benefit, we must consider if the action is proportionate. We discuss this below.

Assessment against applicable objective (b) – competition in generation and supply

The CAP170 AR sets out that at non-compliant derogated boundaries there is a greater volume of constraints relative to the volume of constraints at compliant boundaries, and therefore an increased need to take actions; this results in higher constraint management costs. We noted in our impact assessment that by seeking to reduce the costs associated

[29] See page 181 – document link at footnote 28 above.

[30] £18m potential savings over the full period from April 2010 to March 2011. £14m potential savings if CAP170 was implemented in September 2010. Costs savings are based on CAP170 replacing costs under commercial contracts for this period.

with managing constraints at a derogated non-compliant boundary, CAP170 would have a positive impact in terms of reducing the level of volatility of Balancing Services Use of System (BSUoS) costs for generators and suppliers on the system overall.

We also set out that to the extent that CAP170 would reduce the risk or unpredictability associated with costs behind a non-compliant boundary, which may otherwise act as a barrier to entry to generation and supply, we consider an administered solution such as CAP170 could have a positive impact on promoting competition.

However, we also noted in our impact assessment that the most significant effect of CAP170 in relation to competition might be expected to be in relation to the ancillary services market. We set out in our impact assessment that we support the principle of having a competitive ancillary services market with market-driven prices. Extending administered price intertrip arrangements is at odds with this general principle. However, whilst we support the principle of a competitive ancillary services market, we must be satisfied that this market is competitive in practice (and this assessment must include the extent to which market power may impact on competition). An administered price could be more appropriate if it was demonstrated that it was likely to produce a more efficient outcome than observed pricing in the market.

The majority of respondents have commented on the competition issues discussed in our impact assessment and further consultation, including the market power concerns we discussed. NGET set out in its response that its experience with intertrips at the current derogated Cheviot boundary indicates that the market-based approach is not delivering a competitive (efficient) outcome, such that the administration of intertrip pricing has become necessary. However, NGET also noted that the cost of managing constraints had (at the time of its response) reduced, and for the period 2009/10, was at that time lower than as predicted in the forecast NGET provided for Ofgem's impact assessment.

A number of other respondents questioned why, if constraint costs are excessive due to the abuse of market power, the Competition Act 1998 investigation by Ofgem into SP and SSE was closed. Several respondents were of the view that the enforcement of competition law is more appropriate than imposing administered prices for dealing with market power issues. One respondent considered that whilst intertrips are a useful tool, introducing an administered price solution should only ever be considered as a last resort. Some respondents considered that competition in the ancillary services market is improving, already resulting in lower costs.

We continue to have concerns that historically observed prices for intertrip behind the Cheviot boundary suggest that market power in that area in some periods had resulted in prices that are not cost reflective. We made clear in our decision letter of 19 January 2009[31] that whilst we were closing the Competition Act 1998 investigation into SP and SSE as a result of administrative priority, we remained concerned as to the state of competition in the relevant market. We noted that output from SP's and SSE's generation plant in Scotland appears to have been much more expensive than that of comparable generation in England and Wales at times of constraint, which could potentially indicate the exercise of market power. We agree that it is important to address these concerns, which were the subject of our March 2009 consultation on

[31] The decision letter closing the investigation into SP & SSE can be viewed at the following link: http://www.ofgem.gov.uk/About%20us/enforcement/Investigations/ClosedInvest/Documents1/Competition%20Act%20investigation%20into%20ScottishPower%20and%20Scottish%20and%20Southern%20Energy.pdf

market power issues[32]. We subsequently requested that the Secretary of State consider the inclusion of a market power licence condition in the then forthcoming Energy Bill, and the Energy Act 2010 contains powers relating to the 'exploitation of electricity trading and transmission arrangements'[33].

We note the cost reductions in intertrip behind the Cheviot boundary and the additional level of intertrip services available to NGET in that area. We welcome these developments, which we consider may be due to Ofgem highlighting the issue of high constraints in February 2009, and subsequently CAP170 being raised.

We continue to consider that, in principle, there are circumstances in which an administered price could be appropriate, in particular where competition is not effective in limiting prices. The Authority would, however, have to be satisfied that the administered price was appropriate and the intervention otherwise proportionate.

We have assessed whether the proposed administered prices are appropriate and proportionate by analysis of the cost information gathered from intertrip providers in response to the information requests referred to above. We found that, whilst the CAP170 price is within the range of prices we would expect from a competitive market, it would only be more appropriate than current observed prices under restrictive assumptions. Such restrictive assumptions include the view that the opportunity costs of operating in the BM should not be included in the prices in any period.

CAP170 would apply behind a derogated boundary, where in many periods constraints are unlikely to be able to be resolved by the use of intertrip alone. Hence, in those periods, other, potentially more expensive, constraint resolution measures (such as accepting bids in the BM) are likely to be close substitutes for intertrips. However, CAP170 is based on the same pricing mechanism as CAP076, which applies to non-derogated boundaries, where intertrip is sufficient to resolve the relevant constraint. The CAP076 (and proposed CAP170) price therefore ignores the impact of other alternatives on the efficient price of intertrip. It is therefore not clear to us that the proposed administered price would provide appropriate remuneration for those generators providing this service in the particular circumstances in which CAP170 would apply. It is therefore not clear that CAP170 could be said to better facilitate applicable objective (b).

Our assessment overall

Whilst we think there is still a case for taking action to deal with the issues CAP170 was seeking to address, on balance, and taking into account the issues discussed above, we do not consider that CAP170 better facilitates the applicable objectives overall. In order to intervene in the market process, we need to be satisfied that the intervention would produce a more efficient outcome than market prices. Based on the evidence we have, we cannot be confident that CAP170 prices would be an improvement on prices observed in the market. We therefore consider that we must reject the proposal.

For the avoidance of doubt, our concerns relate to the level of prices proposed in the circumstances in which CAP170 would apply. Putting these concerns aside, we think aspects of the proposal have merit and should be considered further by NGET and industry.

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[32] http://www.ofgem.gov.uk/Markets/WhlMkts/CompandEff/Documents1/Market%20Power%20Concerns-%20Initial%20Policy%20Proposals.pdf

[33] See sections 18 – 23 of the Energy Act 2010. These provisions have yet to be commenced.

In addition, we will continue to monitor the costs associated with intertrip in the context of our ongoing work on SO incentives, and consider to what extent action may be appropriate under the Market Power Licence Condition (which we expect to be in place next year).

Decision notice

In accordance with Standard Condition C10 of NGET's Transmission Licence, the Authority hereby directs that CAP170 'System to generator operational intertripping scheme' not be made.

Stuart Cook,
Senior Partner, Smarter Grids and Governance

Signed on behalf of the Authority and authorised for that purpose.