



Direct Dial: 020-7901-7050

13 February 2006

National Grid Electricity Transmission Plc (NGET),
CUSC Signatories and Other Interested Parties

Our Ref: IND/COD/CUSC/CAP092

Dear Colleague,

Amendment Proposal to the Connection and Use of System Code ("CUSC") - Decision and notice in relation to Proposed Amendment CAP092: "Consistent generation use of system charge liability provisions for transmission access products".

The Gas and Electricity Markets Authority (the "Authority"¹) has considered the issues raised in the Amendment Report² in respect of Proposed Amendment CAP092 "Consistent generation use of system charge liability provisions for transmission access products".

National Grid Electricity Transmission Plc ("NGET")³ recommended to the Authority that Proposed Amendment CAP092 be rejected. However, should CAP092 be approved NGET recommended it take effect as of 1 April 2006 and, in the event that the Authority make a decision to approve CAP092 after that date, it be implemented as of 1 April in the subsequent year.

Having considered the Amendment Report and the CUSC Amendment Panel's views, as well as having regard to the Applicable CUSC Objectives⁴, the Authority has decided not to direct a modification to the CUSC.

¹ Ofgem is the office of the Authority. The terms "Ofgem" and "the Authority" are used interchangeably in this letter.

² CAP092 Amendment Report, 11th November 2005.

³ During the development of this amendment the body discharging National Grid's role with regard to the CUSC was described within the CUSC as National Grid Company plc (NGC). Subsequent to the Amendment Report for CAP092 being sent to Ofgem, CAP105 (an amendment which sought to change the name of NGC to NGET in order to reflect the name change of the Transmission Licence holder for England and Wales) was implemented (on 21 December 2005). On the date of this letter any direction to modify the CUSC would be made by Ofgem to NGET, therefore Ofgem has used this terminology in its decision letter for CAP092.

⁴ The Applicable CUSC Objectives are contained in Standard Condition C10 of the licence to transmit electricity treated as granted to NGET under Section 6 of the Electricity Act 1989 (the "Transmission Licence") and are:

- (a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence; and
- (b) facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity.

This letter explains the background to Proposed Amendment CAP092 as set out in the Amendment Report and sets out the Authority's reasons for its decision.

Background

Transmission access can be secured by purchasing either long or short term products. Transmission Entry Capacity (TEC) provides a user with the right to export power up to the purchased level of TEC at any point during the financial year subject to the payment of Transmission Network Use of System (TNUoS) charges. TNUoS charges are calculated in accordance with the Statement of the Use of System Charging Methodology. In addition, procuring TEC in one year gives the User a free option to secure the same level of access in the subsequent charging year.

CUSC Amendment Proposal 070 (CAP070): "Short-term firm access service", which was approved by Ofgem in September 2004,⁵ introduced two within year transmission access products designed to allow generators to access the system primarily at system peak. Short Term TEC (STTEC) and Short Notice Short Term Firm access (SNSTF) allow a User to purchase blocks of capacity lasting 28, 35 or 42 days. Blocks may be purchased at any time of the year and any number of times within a Financial Year. Access will be granted by NGET where capacity is available and no constraint would be created or exacerbated. Further, the User will be required to pay a non refundable application fee and the relevant ongoing use of system charges, calculated in accordance with the Statement of the Use of System Charging Methodology⁶.

In light of the Authority's approval of CAP070, the Proposer of CAP092, E.ON UK, considered the potential use of short term access products. E.ON UK concluded that the charging arrangements for short term access products, when considered in light of the charging arrangements for long term access, were inequitable and as such created a barrier to the use of short term products.

Proposed Amendment CAP092⁷ was submitted for consideration at the CUSC Amendments Panel Meeting on 24 June 2005. At the meeting the Panel determined that a Working Group should be established to consider the Proposed Amendment.

The Working Group presented its Final Report⁸ to the Amendments Panel on 15 September 2005. The report contained details of a Working Group Alternative Amendment. The Alternative Amendment was a refinement to the Amendment Proposal which the Group did not consider could be implemented in its original form. The Panel discussed the Modification Proposal before determining that it should proceed to wider industry consultation. One Panel member noted that, while it had not been considered by the Working Group, the Panel had previously discussed whether the CUSC was the appropriate place to vary a party's charging liability and asked that this be highlighted in consultation. Another Panel member requested that the Working Group's view that the Proposal in its original form could not be implemented be clearly stated in the Consultation Document.

⁵ www.nationalgrid.com/NR/rdonlyres/83367767-5FFE-4E9B-BCCA-923729519277/3447/CAP70Dir.pdf

⁶ The charging structure for STTEC and SNSTF were introduced via Use of System Charging Methodology Modification Proposal 12: Introducing a new charge for Short-Term Transmission Access. The Authority published its decision not to veto this proposal in April 2005.

⁷ www.nationalgrid.com/NR/rdonlyres/F48C037F-30E0-4459-90A8-97D6C5A974BB/2660/CAP092ConsistentGenerationUseofSystemChargeLiabili.pdf

⁸ www.nationalgrid.com/NR/rdonlyres/3E2779E0-DE92-4638-9C44-AF850C87B36E/1462/WGReportCAP092_v10Final.pdf

As the Working Group had been unable to recommend an Implementation Date for CAP092 the Panel was asked to determine an appropriate Implementation Date consistent with paragraph 8.20.2 of the CUSC. At an extraordinary meeting of the Panel on 9 November 2005 the Panel recommended that, in the event of approval by the Authority, the Proposal be implemented as of the 1 April after the Authority's decision as opposed to immediately after that decision.

A consultation paper was issued on 27 September 2005⁹ with responses invited by 28 October 2005. The final Amendment Report was submitted to the Authority on 11 November 2005¹⁰.

The Proposed Amendment

CAP092 proposes to amend the Use of System liability provisions, contained in paragraph 3.9.2 of the CUSC. The proposed amendment will ensure that a User's total liability for charges during any Financial Year due to the granting of STTEC and/or TEC in respect of a Power Station does not exceed the liability which would have been incurred had the relevant export capacity been provided through TEC alone.

The Proposer considers that that the additive nature of charging liabilities for TEC and STTEC may result in charges which are far higher than the User would have paid had the relevant capacity at a power station been secured via TEC alone. The proposer further considers that STTEC is an inferior product to TEC as it provides Users with fewer rights and that as such it is inequitable and inconsistent that its use should ever lead to a charging liability greater than that of TEC.

The proposer considers that CAP092 would better facilitate achievement of Applicable CUSC Objective (b), by removing the potential for the liability provisions associated with TEC and STTEC to act in a discriminatory manner.

Working Group Alternative Amendment ("WGAA")

Following discussion of how reconciliation between TEC and STTEC charges would operate were CAP092 approved, the Working Group agreed that additional legal text (beyond the illustrative text provided by the proposer) would be necessary in order to clarify the process associated with the reconciliation of payments. The Group formulated a WGAA incorporating revised legal text.

Respondents' views

NGET issued a consultation paper on 27 September 2005 inviting responses from CUSC Parties and interested parties.

NGET received 9 responses to the consultation in respect of CAP092, of which none expressed support for the Proposed Amendment and 2 expressed support for the WGAA.

⁹ www.nationalgrid.com/NR/rdonlyres/970314F1-22A1-4CB8-AD0C-1817EC2A30CB/1774/Consultation_CAP09210.pdf

¹⁰ www.nationalgrid.com/NR/rdonlyres/250E9497-9D2F-4541-9DC5-5D9ADB5345DA/4654/CAP092_FinalARv10.pdf

Two respondents which opposed the introduction of CAP092 suggested that the proposal related to charging issues which should not be addressed via a CUSC Amendment Proposal. A further respondent considered that CAP092 would impede the facilitation of the Applicable CUSC Objectives. Two respondents stated that there was no defect to address. One respondent noted that there is no inequitable treatment as a result of charging arrangements and expressed the view that Users are free to make commercial decisions about the usage of STTEC and TEC.

Three respondents noted that STTEC and TEC are different products, with several respondents noting that STTEC was introduced as a peak product and is priced as such. On this basis, respondents considered that it was inappropriate to link unrelated products. One respondent considered that there was a case for reform of access arrangements and considered that new products should be developed rather than existing products linked.

Five respondents which expressed opposition to CAP092 considered that it had the potential to undermine the primacy of TEC. As such, they considered it could reduce the amount of information available to NGET in planning the transmission network and may be expected to reduce the cost reflectivity of the charging arrangements over time.

Two respondents who supported the Amendment Proposal considered that by increasing the attractiveness of STTEC, CAP092 may be expected to promote competition in both generation and balancing services. One respondent considered that although STTEC and TEC are different products the underlying costs are the same. The respondent also questioned whether any generator would seek to deviate from purchasing TEC given the considerable risks involved in doing so and as such whether a punitive price was necessary. Two respondents also considered that CAP092 would not undermine the charging methodologies, as suggested by NGET, but would serve to establish a principle relating to total charging liability within the CUSC.

The respondents' views are summarised and contained in the Amendment Report in respect of CAP092.

NGET's view

NGET considers that CAP092 does not better facilitate Applicable CUSC Objective (a).

In particular, NGET notes that the Transmission Licence requires it to keep the charging methodologies under constant review and to progress changes to the methodologies where appropriate. NGET considers that, were CAP092 to be implemented, its ability to develop the charging arrangements could be fettered by the existence of a capping arrangement defined within the CUSC. NGET considers that in order to discharge its licence obligations in relation to charging, any such constraint on the liability for charges should be set out in the charging methodology and not in CUSC.

Further, NGET believes that any interaction between these products, and consequentially the impact on their usage that stem from the charging arrangements for these products, should only be dealt with within the charging methodologies. In NGET's view, to do otherwise could be viewed as circumventing existing governance arrangements, which would be inconsistent with the efficient discharge of its obligations under the Transmission Licence.

NGET believes the purpose of the CUSC is to make users liable for charges that are determined in accordance with the TNUoS charging methodology and not to determine

the magnitude of the liability itself. It considers that Standard Condition C10 of the Transmission Licence (“Connection and Use of System Code”) makes such a distinction by excluding from the CUSC matters relating to Standard Condition C5 (“Use of System Charging Methodology”) i.e. the principles and methods through which use of system charges are determined. Accordingly, NGET questions whether, as a matter of principle, the CUSC is the appropriate place to alter a User’s liability to pay transmission charges.

NGET also considers that STTEC and TEC are different products and it would be inappropriate to link these products via a charging cap, as described in CAP092. It also notes the view of respondents that the introduction of CAP092 could undermine the primacy of TEC. While not providing a definitive view on whether CAP092 would do this, NGET considers that were the situation to occur as a result of the implementation of the Amendment Proposal its ability to develop an effective remedy within the charging methodology would also be hindered by the Amendment Proposal.

Implementation and Timescales

The Working Group discussed two different implementation timescales: implementation during the current year or implementation at the start of the next charging year.

The Working Group was unable to recommend an implementation date and in accordance with paragraph 8.19.3(b) of the CUSC respondents’ views were sought on possible implementation dates.

The Proposer of CAP092 (E.ON UK) supported the amendment being made during the current charging year in order that the impact on STTEC payments would occur as soon as possible. The majority of other respondents who commented on this issue considered that any change should be made at the beginning of a charging year as to do otherwise would distort competition in the market.

Given no consensus was reached and, in accordance with paragraph 8.20.2 (g) of the CUSC, the matter was therefore put to the CUSC Amendments Panel for determination. The Panel determined that, should the Authority approve CAP092, implementation should be at the start of the next charging year i.e. 1 April 2006. In the event that the Authority made its decision after this date then the Panel determined that the implementation date should be on the 1 April following the Authority’s decision.

Ofgem’s view

Having considered the Amendment Report and had regard to the Applicable CUSC Objectives, Ofgem considers that neither the CAP092 Amendment Proposal nor the WGAA better facilitate the achievement of the Applicable CUSC Objectives.

General comments

Ofgem notes that respondents’ views are divided as to whether it is appropriate to introduce a cap on the liability for STTEC and TEC charges via the CUSC or via a Use of System Charging Methodology Modification Proposal. Ofgem additionally notes that the possibility of raising such a Modification Proposal was discussed at the Transmission Charging Methodologies Forum on 26 May 2005 and that there was not widespread endorsement for such an approach¹¹.

¹¹ www.nationalgrid.com/NR/rdonlyres/9C9F8C97-70AF-431A-BE5A-9ED23079BFDF/5703/050526TCMFMeetingReportFinal.pdf

Ofgem acknowledges that this is an issue which has relevance both in relation to the CUSC and under the charging methodologies. Further it is noted that this is not unique to this proposal and that there is frequently an overlap between issues considered within the governance of these documents. However, the Proposal has been submitted to Authority as a Proposed Amendment to the CUSC. Consequently, the Authority must make a judgement on the proposals in relation to whether it better facilitates the Applicable CUSC Objectives.

Original Amendment Proposal

Ofgem notes the view of respondents and one Panel member that the Amendment Proposal in its original form could not be implemented without further development of the legal text relating to the reconciliation of payments. Ofgem agrees with this view on the grounds that it would prevent the reconciliation of charges between STTEC and TEC payments thereby rendering the modification unable to discharge its stated objective of capping charges. As such, the Authority considers that the Amendment Proposal would fail to better facilitate achievement of either of the Applicable CUSC Objectives.

Working Group Alternative Amendment (“WGAA”)

Applicable CUSC Objective (a) “the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence”.

Ofgem notes that the Transmission Licence requires NGET to keep its charging methodologies under constant review and to progress changes to the methodologies where appropriate. Ofgem further notes respondents’ views that, were CAP092 to be implemented, there would be a considerable risk that NGET would be unable to fulfil the obligations placed on it by the Transmission Licence because of the constraining nature of the cap on charging liability.

Ofgem does not accept that the Proposal would fetter NGET’s ability to subsequently develop its charging arrangements as required by its Transmission Licence. If NGET consider a change to the charging arrangements could result in it better meeting its relevant objectives then it is required to bring forward that proposal for further consideration. Ofgem acknowledges that this could require consequential changes to the CUSC. These would be considered against the Applicable CUSC Objectives.

What this does highlight however, is that the proposal may add an additional level of complexity to changing the charging arrangements, which may not be consistent with NGET efficiently discharging its obligations. Indeed, it may delay changes to charging arrangements which would better meet the relevant objectives. Therefore, at a minimum, the Authority is of the view that the proposal would not result in NGET being able to more efficiently discharge its functions under the Transmission Licence.

Applicable CUSC Objective (b) “facilitating effective competition in the generation and supply of electricity, and (so far as consistent) facilitating such competition in the sale, distribution and purchase of electricity”.

Ofgem agrees with the respondents that considered that increased usage of short term access products may be expected to more efficiently utilise the existing network and thereby increase competition in generation and, potentially, balancing services. Ofgem is

also not convinced that capping the total liability for TEC and STTEC charges would undermine the primacy of TEC. There is a greater degree of risk where capacity is constrained and there are competing requests for available capacity associated with attempting to procure short term access products, and multiple application fees.

Notwithstanding this, Ofgem does not consider that capping STTEC charges in the manner proposed is in the best interests of competition. Ofgem notes that STTEC was introduced as primarily a peak product, designed to provide increased flexibility to generators in the event that spare capacity is available. TEC provides a generator with firm access rights at any point during a year and provides long term investment signals to NGET. Ofgem considers that STTEC and TEC are different products and that linking the liabilities for the two products may impede the independent operation of both products. As a result Ofgem is of the view that the Proposal would be likely to dilute the choice available to generators thereby hindering "effective" competition in the generation of electricity.

Another concern in relation to competition stems from the points raised above on the interaction between changes to both the CUSC and charging methodologies. If, on one hand, charging arrangements are amended via modifications to the Statement of the Use of System Charging Methodology while on the other changes to total charging liabilities can be altered via CUSC Amendment Proposals, this creates considerable uncertainty for users of the system of the future pattern of changes in the charging arrangements. Equally the additional level of complexity to changing the charging arrangements, which was noted above, would further fuel uncertainty regarding the likelihood and timing of changes. The Authority therefore considers that the Proposal would lead to increased uncertainty which is entirely inconsistent with the better facilitation of Applicable CUSC Objective (b).

Conclusion

Ofgem recognises that the Proposed Amendment could be argued in some respects to better facilitate competition. However, this must be offset both against the implications of linking the liabilities of two different products and also in a wider sense against the ability of the licensee to efficiently discharge its functions.

On balance, Ofgem considers that the Proposed Amendment and the Working Group Alternative Amendment fail to better facilitate achievement of the Applicable CUSC Objectives.

The Authority's notice

The Authority has therefore decided not to direct an amendment to the CUSC as set out in the Amendment Report.

Yours sincerely,



Robert Hull
Director Transmission

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