

National Grid Electricity
Transmission plc, all transmission
system users, parties to the
CUSC and all other interested
parties



*Promoting choice and
value for all customers*

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Dear stakeholders,

Consultation on Connection and Use of System Code ('CUSC') modification proposals ('CMP') 209 and 210

We are seeking further information on proposed changes to the Statement of the Use of System Charging Methodology¹ (CMP209) and the CUSC² (CMP210). Taken together these proposals would allow suppliers with negative net demand (or in some cases embedded generators) to receive payments on a monthly basis under the Transmission Network Use of System (TNUoS) charging rules applied by National Grid Electricity Transmission plc (NGET).

Based on the information that is currently available, our preliminary view is that we are inclined towards not directing the implementation of the proposals. However, we consider that there are areas where further clarification is required in order to make a full assessment and reach a decision.

In order to make a full assessment, we are seeking further information on the questions identified in this letter by 7 May 2013.

The section below describes a high level overview of the background to the proposed changes and our preliminary views. Further information, including our preliminary assessment of the proposals, is set out in annex 1.

Background

NGET charges users for use of the transmission system in accordance with the TNUoS charging rules set out in the CUSC.

In normal circumstances, embedded generation reduces a supplier's TNUoS charge³. The assumption is that embedded generation will not result in an export flow from a distribution network to the national electricity transmission network (i.e. a supplier's net demand is assumed to be positive after accounting for the output of generation connected to the distribution network). The current charging rules reflect this and prohibit suppliers from submitting a negative net demand forecast.

Suppliers with negative net demand are a relatively new (and growing) feature of the electricity market in Great Britain, resulting from an increase in embedded generation over the last decade.

¹ The Statement of the Use of System Charging Methodology can be found in Section 14 of the CUSC.

² Specifically, Sections 3 ('Use of System') and Section 11 ('Interpretations and Definitions')

³ Depending on its meter registration, the output of an embedded generator would either contract with a supplier and have its output deducted from a supplier's demand requirements and reduce a supplier's TNUoS charge, or directly receive the demand TNUoS tariff credits from NGET.

Under CMP209 suppliers would be allowed to submit a negative demand forecast for the charging year⁴. This would enable affected parties to receive payments within a charging year rather than wait to have the money credited back at the annual reconciliation. The changes proposed under CMP210 relate to the financial security that suppliers are required to provide to mitigate the risk of default.

Preliminary Assessment and request for information

Having considered the analysis, and the Panel members' views and interpretation of this assessment as presented in the modification reports, we have decided to consult following our own provisional assessment of the proposals against the relevant objectives. This includes our preliminary view that we are inclined not to direct the implementation of the proposals. This view is explained in annex one for information. Our thinking is based on the evidence and information provided through the CUSC governance process to date.

We consider that there are areas where further clarification is required for us to make a full assessment and reach a decision. With this in mind, we welcome views in the following areas.

1. We note that the changes required to systems and forecasting processes are not specified, although we understand these may be delivered through a consequential change to the Balancing and Settlement Code. We would welcome realistic estimates of the costs (including any administration and resource costs where appropriate) associated with the two solutions proposed under CMP209.
2. Views, with supporting information and analysis where practicable, on the impact on competition in supply and generation and any impact on consumers associated with the two solutions proposed under CMP209.
3. We are mindful of the potential interaction between CMP209/10 and the wider industry review of the treatment of embedded generation in the transmission charging arrangements to be initiated by NGET later in the year⁵. We would be interested in any views on the potential circumstances in which the proposed wider review could lead to wasted work (in the event that CMP209 and 210 were approved and implemented from 1 April 2014).

We also welcome any other views on our provisional assessment set out in annex 1.

Next steps

Responses to this consultation should be submitted on or before 7 May 2013 to Anthony.mungall@ofgem.gov.uk. All non-confidential responses will be published on our website. Therefore, if you do not wish all or part of your response to be made public, you should clearly mark your response as confidential. It would be helpful if any confidential information could be contained within a separate appendix in order that the main response and any non-confidential information may be published.



Andrew Burgess

Associate Partner, Transmission and Distribution Policy

Signed on behalf of the Authority and authorised for that purpose

⁴ The Workgroup decided not to progress similar changes in respect of Non Half Hourly metered customers as it considered that net negative forecasts were unlikely to occur for these customers.

⁵ NGET has committed to launching a review during 2013 with the aim of seeking a decision from us on enduring charging arrangements in 2014 and implementing arrangements, if approved, from April 2016.

http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Documents1/NGET%20letter%20relating%20to%20the%20review%20of%20C13_5-3-12.PDF

Annex 1: Our preliminary views

Background to the modification proposals

Under the current TNUoS Methodology, generation TNUoS charges apply to generators directly connected to the transmission system and to licensed⁶ generators with a Bilateral Embedded Generation Agreement (BEGA) that are connected to the distribution networks (embedded generation). All other generation is treated as negative demand from a transmission charging perspective. This means that they are not liable for the generation TNUoS tariff and receive a TNUoS credit as determined by the demand TNUoS tariff⁷. These are referred to as TNUoS “embedded benefits”.

Currently, demand TNUoS charges apply to suppliers based on the sum of their demand liabilities from their half hourly (HH) customers (on capacity based TNUoS tariffs) and non-half hourly (NHH) customers (on energy consumption based TNUoS tariffs). TNUoS charges are therefore based on the Balancing Mechanism Unit (BMU) level HH metered demand forecasts during Triad⁸ and NHH consumption forecasts over the financial year.

The forecasts provided by each supplier are on a “net” basis, with embedded generation output deducted from the demand of a local supplier. Therefore, in normal circumstances, embedded generation reduces a supplier’s TNUoS charge⁹, giving it a TNUoS embedded benefit. The increase in embedded generation over the last decade has increased the potential for suppliers to receive a TNUoS embedded benefit payment and the likelihood of some suppliers having more export than import (i.e. a negative net demand).

Where a supplier’s net demand is positive, it is subject to a demand TNUoS charge based on its forecast net demand (and invoiced on a monthly basis). These charges are then adjusted to reflect actual net demand. Suppliers are currently prohibited from submitting a negative net demand forecast and must instead submit a forecast of zero. Therefore if a supplier has net exports in a BMU (i.e. their net demand is negative) it will not receive its embedded benefit TNUoS credits in the monthly TNUoS invoices it gets from NGET. Instead these suppliers receive a payment after reconciliation by NGET. Payments are normally made in June or July of the following charging year.

The modification proposal

Opus Energy (the proposer) raised CMP209 and CMP210 (jointly “CMP209/10”) in April 2012, with the aim of improving competition in the supply of electricity and the cost reflectivity of charges. CMP209 proposes changes to the Methodology and is assessed against the relevant objectives. The changes proposed under CMP209 relate to suppliers’ forecasts of net demand. CMP210 proposes changes to the wider CUSC and is assessed against the applicable objectives. The changes proposed under CMP210 relate to the financial security that suppliers are required to provide to mitigate the risk of default.

Under CMP209/10 suppliers would be allowed to submit a negative demand forecast for the charging year in respect of half hourly metered distribution connected customers¹⁰. This would allow suppliers (or embedded generators, depending on the meter registration) to receive the TNUoS embedded benefit payments on a monthly basis within that charging year rather than wait to have the money credited back at the annual reconciliation. Monthly payments would be made by NGET based on the forecast net demand provided by the supplier until actual net demand is confirmed at reconciliation.

⁶ Generally, all parties with a generating capacity of 100MW or more are required to hold a generation licence.

⁷ This approach is based on the principle that licence-exempt embedded generation is deemed not to be using the electricity transmission system.

⁸ The Triad describes the three settlement periods of highest system demand within a Financial Year.

⁹ Depending on its meter registration, the output of an embedded generator would either contract with a supplier and have its output deducted from a supplier’s demand requirements and reduce a supplier’s TNUoS charge, or an embedded generator can contract directly with NGET to receive the demand TNUoS tariff credits.

¹⁰ The Workgroup decided not to progress similar changes in respect of Non Half Hourly metered customers as it considered that net negative forecasts were unlikely to occur for these customers.

Under CMP209/10 the risk associated with paying suppliers in advance of Triad would be mitigated by extending the security arrangements which currently apply to suppliers with a positive net demand to cover suppliers with a negative net demand.

The CUSC Workgroup assessing CMP209/10 also developed an alternative solution to address the perceived defect (WACM1). The two solutions propose different changes to the Methodology under CMP209. Under the original proposal, suppliers would submit forecasts based on gross information of demand and generation from which net demand would be calculated. Under WACM1, forecasts provided by each supplier would be net, with embedded generation netted off against demand. The changes in respect of security requirements under CMP210 are the same for the original proposal and WACM1.

The proposed implementation date for the original proposal and WACM1 is 1 April 2014.

CUSC Panel recommendation

The Panel voted on CMP209/10 at its meeting on 30 November 2012. The majority of Panel members voted that the original proposal better meets the relevant objectives and the applicable objectives compared to the CUSC baseline and to WACM1 and so should be implemented. The full views of Panel members appear in the Final Modification Report ("the Report").

Our preliminary view

We have considered the issues raised by the proposals under CMP209 and CMP210 as set out in the Report. We have considered and taken into account the responses to the Code Administrator consultation, which are attached to the Report. Based on our provisional assessment of the proposals against these objectives taken as a whole, our preliminary view is that:

- on balance the proposals under CMP209 would not better achieve the relevant objectives; and
- CMP210 would not better achieve the applicable objectives.

Our preliminary assessment (CMP 209)

Our preliminary view is that the original proposal and WACM1 have the potential to better achieve relevant objectives (a) and (b) and have a negative impact in respect of relevant objective (c). We note that the benefits (in terms of improvements to competition and cost reflectivity) have not been quantified but appear to be quite small and have not been demonstrated to outweigh the risk of any changes being temporary and leading to wasted work.

We set out below our provisional assessment of CMP209 against each of the relevant objectives. Our provisional assessment against each of applicable objectives concludes the section below.

Objective (a) 'that compliance with the use of system charging methodology facilitates effective competition in the generation and supply of electricity and (so far as is consistent therewith) facilitates competition in the sale, distribution and purchase of electricity'

In our current view, both the original proposal and WACM1 would provide a more equal environment by ensuring charges and payments all occur within the relevant charging year. We consider that this would be expected to improve competition in the supply of electricity relative to the baseline.

Under the current arrangements, suppliers with positive net demands make monthly payments to NGET (in its role as SO) across the relevant charging year, but suppliers with a negative net demand receive a payment from NGET for TNUoS embedded benefits in June/July of the following charging year, once the initial reconciliation of demand charges has been undertaken by NGET. Our provisional view is that this approach gives net positive suppliers a slight

advantage over negative net suppliers in terms of the relative timing of payments from NGET for TNUoS embedded benefits. This could have a negative impact on competition.

We note NGET's view that suppliers do not pass on payments for TNUoS embedded benefits to embedded generation until the initial reconciliation of demand charges has been undertaken by NGET. NGET considers the timing of payments between suppliers and their customers is the main driver of suppliers' cash flow, and not the timing of payments to suppliers from NGET or the manner in which demand forecasts are provided to NGET. Therefore, NGET believes that neither the original nor the WACM1 proposal better facilitates relevant objective (a).

As noted above, the potential negative impact on competition under the current arrangements relates to the relative timing of payments between NGET and suppliers, which we currently consider gives a slight advantage to positive net suppliers. We do not consider that the timing of payments between suppliers and their customers affect this.

We also note the opinion of some suppliers that if either the original proposal or WACM1 were implemented then embedded generation would expect to receive payments for TNUoS embedded benefits in advance of Triad increasing risk to all suppliers, and this could have a negative impact on competition. In our current view, the timing of payments from suppliers to embedded generation is a commercial matter for suppliers and generators to decide.

We have also considered whether the original proposal or WACM1 may have a negative impact on competition in the generation of electricity by exacerbating what some industry parties perceive as an advantage of embedded generation over transmission connected generation under the current TNUoS charging arrangements. We understand that this perceived advantage is in respect of the value of TNUoS embedded benefit payments received from NGET. In our view, this modification seeks to address the timing of TNUoS embedded benefit payments, and not the value of any payments. We also note that this issue was not fully investigated by the Workgroup. Based on the above, we are currently of the view that the original proposal and WACM1 are neutral in respect of the facilitation of competition in the generation of electricity.

We currently consider that both the original proposal and WACM1 have the potential to better achieve this objective relative to the baseline but that the impacts do not appear to be significant.

Objective (b) 'that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs (excluding any payments between transmission licensees which are made under and in accordance with the STC) incurred by transmission licensees in their transmission businesses and which are compatible with standard condition C26 (Requirements of a connect and manage connection)'

The original proposal and WACM1 will affect the timing of payments to suppliers with a negative net demand. This may have a small positive impact on the cost reflective signal provided by these payments relative to the baseline. This is because the TNUoS charges will better reflect costs as embedded benefits flow closer to when they are incurred and not delayed until the following charging year. However, based on the analysis and information available in the Report, our provisional thinking is that in general any impact on the cost reflective signal is unlikely to be significant.

We currently consider that both original proposal and WACM1 have the potential to marginally better achieve this objective relative to the baseline.

Objective (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'

We note that the suppliers with negative net demand are a relatively new (and growing) feature of the GB electricity market, resulting from an increase in embedded generation over the last decade. We also understand that the rule prohibiting negative net forecasts was

introduced at a time when suppliers with negative net demands were considered extremely rare.

We see this as a development in the licensees' transmission businesses and consider that normally the original proposal could be seen properly to take account of this development. However, we are also aware that, as part of our decision to extend the expiry date of standard licence condition C13 ('Adjustment to use of system charges (small generators)')¹¹, NGET has committed¹² to reviewing the treatment of embedded generation from a transmission charging perspective during 2013, with the aim of seeking a decision from us on enduring charging arrangements in 2014 and implementing arrangements, if approved, from April 2016 at the latest. The purpose of the review is to ensure that appropriate and codified arrangements are in place which accurately reflect the impact of embedded generation on the transmission network.

We note that the changes required to NGET's systems and forecasting processes in the case of the original proposal¹³, facilitated through a consequential BSC modification, may become obsolete within two years of implementation (i.e. if implemented in April 2014 it may be replaced by enduring arrangements implemented from April 2016). We are seeking to establish whether the changes required to implement the original proposal are an appropriate use of industry time or resource (at consumers' expense) given the potentially temporary nature of the change. Our provisional thinking, based on the evidence presented so far, is that the original proposal would not be a proper or reasonably practicable way to take account of developments in the licensees' transmission businesses.

We also note that forecasts of negative demand are considerably more volatile than those of positive demand, and therefore carry with them a greater risk of inaccuracy. This is particularly so for variable generation such as wind. The risk associated with inaccurate forecasting can be mitigated to some degree by requiring suppliers to submit detailed forecasts of gross demand and gross generation, as proposed under the original proposal. We consider that this risk would not be appropriately mitigated under WACM1 which only requires net forecast. Consequently, we do not consider that WACM1 properly takes account of developments in the TOs' businesses discussed in this section.

Our provisional view is that neither the original proposal nor WACM1 better achieves this objective.

Our preliminary assessment (CMP 210)

As discussed above, CMP210 would extend security arrangements in place for suppliers with a positive net demand to cover suppliers with a negative net demand, under both the original proposal and WACM1.

If CMP209 were to be rejected for the reasons discussed above, suppliers would not be able to submit negative demand forecasts. Consequently, CMP210 would have no effect and would be neutral in respect of all the applicable objectives.

Preliminary view

Our preliminary view is that we are not inclined to direct the implementation of the proposals submitted under CMP209 and CMP210. This is because the gains (in terms of improvements to competition and cost reflectivity) do not seem to outweigh the risk of wasted work (and costs to consumers) arising from the review to embedded generation charging that is due to commence later this year. We are seeking further information on these issues ahead of making our final decision.

¹¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=211&refer=Licensing/Work/Notices/ModNotice>

¹²

http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Documents1/NGET%20letter%20relating%20to%20the%20review%20of%20C13_5-3-12.PDF

¹³ NGET advised that changes to its IS systems would require in the region of 6-9 months minimum to capture changes required as a result of implementation of the original proposal.