



Mr Ben Graff
GCRP Chairman
The National Grid Company plc
National Grid Transco House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

*Bringing choice and value
to customers*

Your Ref: Our Ref: blm / I 038
Direct Dial: 020 7901 7366
Email: john.scott@ofgem.gov.uk

20 August 2004

Dear Ben

STANDARD CONDITION 7 : TRANSMISSION LICENCE, LICENSEE'S GRID CODE

The Gas and Electricity Markets Authority (the "Authority")¹ has carefully considered the recommendation that a change should not be made to the Grid Code that the National Grid Company plc ("NGC") has proposed in the report to the Authority arising from consultation D/01 (Provisions Relating to Embedded Large Power Stations) that has been submitted to it for approval.

In accordance with Condition 7 of NGC's transmission licence, the Authority has decided to approve the recommendation not to make a change NGC's Grid Code (the "Grid Code") and therefore the Authority does not propose to direct NGC to make any changes to the Grid Code arising from the matters set out in consultation D/01 (Provisions Relating to Embedded Large Power Stations).

This document explains the background to the proposals and sets out the Authority's reasons for its decisions to approve NGC's recommendation not to make changes to the Grid Code. This letter constitutes notice by the Authority under Section 49A of the Electricity Act 1989 in relation to the directions contained or referred to in this letter.

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

Background

The qualification in BC1.6.1(a)(i) of the Grid Code relating to distribution constraints formed one part of the changes that were consulted on and implemented as part of the introduction of the NETA. As a consequence of this qualification, large embedded power stations² do not receive compensation payments or protection from exposure in the balancing mechanism when their output is constrained due to failures of a part of a distribution network. Under the Pool, this class of generator was centrally despatched and hence received compensation payments (notionally equal to their lost profit i.e. the difference between the Pool price and their offer price) when their scheduled output was constrained because of distribution system operation. Several large embedded power stations have argued that the introduction of NETA did not justify this change in treatment and pressed for compensation payments to be reinstated for distribution failures.

Consultation D/01 (Provisions Relating to Embedded Large Power Stations) was issued by NGC in response to requests from Users to review the obligation in BC1.6.1(a)(i) that was introduced as part of the NETA changes to the Grid code. BC1.6.1(a)(i) requires generators to ensure that Physical Notifications that they submit take account of the constraints on the user system to which the power station is connected. In consultation D/01 (Provisions Relating to Embedded Large Power Stations), NGC consulted on a change to the Grid Code to remove this requirement to submit unconstrained data for generators who were previously subject to central despatch. In its consultation, NGC noted that such a change to the Grid Code may have implications on other parts of the Grid Code and on other industry documents. The scope of these implications was outlined in NGC's consultation as a high level (only identifying the relevant documents). The consultation did not include a detailed description or propose drafting for changes to other parts of the Grid Code. However, in its consultation, NGC identified a number of options by which the trading arrangements could be changed such that large embedded power stations would receive protection from exposure in the Balancing Mechanism when their output is constrained due to failures of a part of a distribution network. These options included the development of BSC modifications and the establishment of bilateral agreements between the distribution network operator and the generator in relation to compensation payment arrangements. The alternatives were not within the scope of the Grid Code governance arrangements and as such were only referenced as possible work areas in consultation D/01 (Provisions Relating to Embedded Large Power Stations) for completeness and have not been progressed in detail.

NGC's View

NGC was asked by generator representatives to review clause BC1.6.1(a)(i) of the Grid Code. In particular, NGC was asked to consider an amendment to the Grid Code to allow generators with large embedded power stations that were connected at or before 27 March 2001, to submit data that does not take account of distribution constraints. As a consequence of these requests, NGC reviewed the Grid Code and identified a possible change proposal. NGC consulted on this change but highlighted that it did not consider that the proposed Grid Code change would introduce the rights for compensation that the generators were seeking.

² Large embedded power stations are defined in the Grid Code as generators of 100MW or larger that are connected to a distribution network.

In addition, NGC observed that compensation arrangements for constraints due to distribution network unavailability were not part of the NETA design and noted that it considered this to be appropriate given that NGC does not have a role in the management of distribution constraints. NGC also noted that the volume (and therefore costs) of distribution constraints is predominantly affected by investment decisions by the relevant distribution network operator (which are taken in consultation with a customer when terms of a connection are agreed).

NGC has noted also its support for the principle of non discrimination between classes of generators and identified that the current arrangements do not discriminate between transmission and distribution connected generation in relation to constraints due to transmission network unavailability. NGC also identified its concern that any proposal to introduce compensation payments for distribution constraints via the Balancing Services Use of System ('BSUoS') charging arrangements would reduce the efficiency of the existing trading arrangements as well as introducing a different treatment for one class of generator that is participating in the Balancing Mechanism ('BM').

Respondents' Views

NGC reported that it received 15 responses to consultation D/01 (Provisions Relating to Embedded Large Power Stations), of which:-

- 8 respondents supported the Grid Code change proposal option presented to amend the qualification in BC1.6.1(a)(i) which requires generators to account for distribution constraints in the BM Unit Data submitted.
- 4 respondents did not consider that a change to the Grid Code was an appropriate solution to this issue and supported NGC's recommendation not to make a change to the Grid Code.
- 3 respondents did not raise objections or indicate strong support for any of the possible options identified.

The industry did not reach a consensus view on this issue.

Of the eight respondents who supported the proposal to amend the qualification in BC1.6.1(a)(i) all have generation interests. These respondents considered that the existing Grid Code obligations discriminate between large power stations connected to transmission and distribution networks because large embedded power stations are exposed to the additional commercial risk of imbalance as a result of unplanned distribution constraints. Six of these respondents felt that the proposed change to BC1.6.1(a) should apply only to generators who were previously subject to central despatch (under the Pool) although one respondent queried the need for such a limit and considered that the proposed change could apply to all large embedded power stations that are and may in the future be connected to a distribution system. One other respondent (of these eight) considered that all embedded power stations should be permitted to submit unconstrained data.

One respondent who did not have strong views on the proposed options observed that the materiality of the NETA change that introduced the qualification to BC1.6.1(a) was very small for two existing large embedded power stations³. Other respondents of the eight who were supportive of a change to the Grid Code noted that it would result in only a small increase to BSUoS charges for BSC parties.

Two respondents who supported the proposal considered that there is an inconsistency in the obligations in BC1.6.1 and queries whether BC1.6.1(b) and BC1.6.1(c) have any purpose given the qualification in BC1.6.1(a)(i). These respondents considered that the proposed change to BC1.6.1(a)(i) would introduce rights for large embedded power stations to receive compensation payments for distribution constraints without requiring consequential changes to other industry documents. One of these respondents also considered that extensive changes to the Grid and Distribution codes would be needed to maintain the existing arrangements.

Of the four respondents who did not consider that a change to the Grid Code should be made, all have distribution network operator interests. These respondents noted concern that the consequential impacts of the proposed change to BC1.6.1(a) have not been sufficiently considered and that the materiality of the resultant cost increases across the industry had not been assessed. Some of these respondents commented that the Grid Code forum was not appropriate for consideration of this commercial matter. One respondent observed that distribution network operators should not be exposed to the risk of balancing costs and that arrangements for compensation payments for large embedded power stations should be considered as part of the next Distribution Price Control Review.

NGC's recommendation

NGC recommends that the Authority approves its decision not to propose changes to the Grid Code as set out in the report to the Authority arising from consultation D/01 (Provisions Relating to Embedded Large Power Stations).

Ofgem's view

Ofgem agrees, having had regard to the licensee's objectives set out in condition 7(1)(b) of the Transmission Licence ("the objectives") and Ofgem's statutory duties, that the proposed changes to NGC's Grid Code should not be made. Ofgem's reasons for reaching this decision are outlined below.

Ofgem considers that the change to the Grid Code that was identified in the report to the Authority arising from consultation D/01 that NGC submitted would not introduce a mechanism for compensation payments for distribution constraint for large embedded power stations and is concerned that the consequential impacts on other industry documents and operational practices have not been adequately assessed. Ofgem considers that it was not inappropriate for NGC to have made its recommendation not to propose a change to the Grid Code based on the high level wider impact assessment that was included in consultation D/01 (Provisions Relating to Embedded Large Power Stations) in light of the evidence of the zero level of compensation payments that it made to large embedded power stations under the Pool for the period 1995/6 until 2000/1.

³ There are currently 15 large embedded power stations in England and Wales.

Ofgem notes its concern that this commercial matter was raised for consideration at the technical forum of the Grid Code Review Panel. As previously indicated, Ofgem does not consider the Grid Code Review Panel to be a suitable forum to consider a commercial issue that affects distribution connected generators.

Ofgem considers that any compensation mechanism for distribution system constraints should be linked to incentives on distribution licensees to minimise distribution network unavailability. Ofgem has set out its thoughts on such a mechanism in its consultation papers on the distribution price control review⁴⁵.

Furthermore Ofgem is concerned that there should not be different treatment between similar classes of customers and notes that all large power stations whether transmission or distribution connected are entitled to compensation when their output is constrained due to transmission network unavailability.

Ofgem has reviewed BC1.6.1 of the Grid Code and notes that the scope of the data provided in accordance with BC1.6.1 is not limited to constraints affecting the output of large embedded power stations. Ofgem has not identified any inconsistencies between the obligations within BC1.6.1.

Ofgem notes that two respondents considered that extensive changes would be needed to the Grid and Distribution Codes to maintain the existing arrangements. However, Ofgem has not identified any changes that would be needed to the Grid or Distribution Codes to maintain the existing arrangements that support the BSUoS charging mechanisms in relation to the treatment of constraints due to distribution network unavailability.

Ofgem believes that the Grid Code amendment that was considered to the Grid Code as part of this review described in NGC's consultation D/01 (Provisions Relating to Embedded Large Power Stations) is not consistent with NGC's objectives with respect to the Grid Code or Ofgem's statutory duties. In particular, Ofgem notes that the removal of the obligation on generators to take account of distribution constraints when submitting notifications to NGC:

- Could adversely impact on the efficient operation of the electricity transmission network by impairing NGC's ability to co-ordinate flows of electricity on the transmission network.
- Is outwith the scope of the objective of the Grid Code to facilitate the transmission system being made available on terms that do not prevent or restrict competition in generation of electricity as it relates to the treatment of distribution system constraints.
- Would not promote the security and efficiency of the electricity generation, transmission and distribution systems as a whole as NGC does not have any influence over the management of distribution system constraints.

⁴ 'Electricity distribution price control review Appendix - Further details on the incentive schemes for distributed generation, innovation funding and registered power zones', June 2004, Ofgem 145b/04.

⁵ Any ongoing issues relating to compensation arrangements for distribution connected generation should be referred to Martin Crouch, Director - Distribution (martin.crouch@ofgem.gov.uk).

As part of the BETTA⁶ development work, Ofgem/DTI consulted on a draft GB Grid Code in September 2003⁷. This draft was based on NGC Grid Code Issue 2 Revision 12 which included the qualification to clause BC1.6.1(a). The Authority notes that no issues were raised by respondents to that consultation on the application of BC1.6.1(a) on a GB basis. As such the Authority did not consider there to be a need for a separate GB consultation to inform its decision on the report to the Authority arising from consultation D/01(Provisions Relating to Embedded Large Power Stations) that NGC submitted. However for completeness the Authority invited views on the GB wide impact of NGC's recommendation in its recent consultation on the Grid Code under BETTA⁸ which was also published in the form of an open letter to the chairman of the GCRP⁹. The Authority notes that no comments were made by respondents to these consultations in relation to the report to the Authority arising from consultation D/01 ((Provisions Relating to Embedded Large Power Stations).

The Authority's decision

The Authority has therefore decided to approve the recommendation not to propose changes to the Grid Code as set out in the report to the Authority arising from consultation D/01(Provisions Relating to Embedded Large Power Stations) that NGC submitted and is not directing NGC to make any changes to the Grid Code in relation to the matters raised by that consultation.

Please do not hesitate to contact me on the above number if you have any queries in relation to this decision or alternatively contact Bridget Morgan on 020 7901 7080.

Yours sincerely

A handwritten signature in black ink that reads "John Scott". The signature is written in a cursive style and is underlined with a single horizontal line.

John Scott

Technical Director

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

cc: David Payne, GCRP Secretary

⁶ British Electricity Trading and Transmission Arrangements

⁷ 'The Grid Code under BETTA, Ofgem/DTI conclusions and consultation on the text of a GB Grid Code and consultation on change co-ordination between the STC and user-facing industry codes' Ofgem/DTI, September 2003. Ofgem 111/03.

⁸ 'The Grid Code under BETTA, Ofgem/DTI conclusions and consultation on the text of a GB Grid Code and conclusions on change management between the STC and each of the GB CUSC, GB BSC and GB Grid Code' Ofgem/DTI, May 2004. Ofgem 99/04a and 99/04b.

⁹ 'GB Consultation on Changes to the Grid Codes- letter to Mr Ben Graff GCRP Chairman' (http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/7066_10104.pdf).