

Charging Issues Standing Group

Tuesday 20th November, 2007

Post meeting note – embedded benefit

As Agenda item 3, National Grid provided an update on the work thus far undertaken regarding the determination of an appropriate valuation for the reduced transmission expenditure resulting from a Users decision to connect to the distribution system.

National Grid proposed that the use of the revenue drivers determined as part of the Transmission Price Control Review (TPCR) presented a relevant proxy for determining the value of the transmission expenditure avoided for local generation works. This equates to an average annuitised value of approximately £1.50/kW.

National Grid agreed to publish a post meeting note referencing the revenue driver information with a covering explanation.

Published information

A full explanation of the revenue drivers mechanism can be found in Chapter 9 - Adjustment Mechanisms and Incentives: Electricity, of the TPCR document published on the Ofgem website. A hyperlink to the document is included below:

http://www.ofgem.gov.uk/Networks/Trans/PriceControls/TPCR4/ConsultationDecisionsResponses/Documents1/16342-20061201_TPCR%20Final%20Proposals_in_v71%206%20Final.pdf

Revenue drivers

In summary, throughout the TPCR, Ofgem advocated the need for funding to be able to respond flexibly to the changing demands for capacity on the transmission system from new and existing generators, to ensure that funding for investment is targeted where it is needed and to ensure that consumers do not fund anticipated investment which turns out not to be required.

Revenue drivers are rules set out in advance by Ofgem, to define how allowances adjust for differences between what has been assumed in setting the baseline allowances and what actually happens. If generation capacity grows more quickly than initially assumed, then allowances will automatically increase. Conversely, if generation capacity grows more slowly than assumed, then allowances are scaled back. There are some differences in the incentive schemes applied to each of the Transmission Owners (TOs).

SPTL and SHETL

The revenue drivers for SPTL and SHETL are linked to the amount of generation that connects over the period 1 April 2005 to 31 March 2012. The key parameters of the scheme are:

- the volume of generation (MW) assumed to be connected in the baseline;
- the capital expenditure (£m) and unit cost (£/kW) considered to be consistent with this baseline volume;
- the unit cost is considered to be appropriate for connected volumes of generation over and above the baseline.

Once the baseline volume of generation has been connected, additional allowances depend on the volume of extra generation connected, as well as a proportion (75 percent) of the actual costs of work-in-progress for the more advanced new connection projects. Table 9.1 of the document sets out the final proposals:

Table 9.1 Revenue drivers for SPTL and SHETL

	BASELINE			REVENUE DRIVER
	Volume (MW)	Allowance (£m)	Unit cost (£m/MW)	Unit cost (£m/MW)
SPTL	1,734	94.4	0.054	0.052
SHETL	1,489	35.4	0.024	0.032

The adjustments to revenues within this framework are made in two ways. Firstly, by adjusting the allowance assumed in applying the proposed capital expenditure incentive for the generality of capital expenditure at the end of the price control period. Secondly, once the baseline volume of generation has been connected, by increasing allowances within the period to allow depreciation and a rate of return on:

- 75% of actual additional costs incurred; and
- A further capital sum based on 25% of the estimated unit cost once generation is connected.

Projects which cost more than £0.130 million per MW for SHETL and projects which cost more than £0.163 million per MW for SPTL however, are excluded from the scope of the revenue drivers scheme to ensure that they do not unduly influence the profit or loss for the companies under the scheme by distorting the unit cost allowances.

NGET

Revenue drivers for NGET are also linked to the amount of generation that connects over the period 1 April 2005 to 31 March 2012. Due to the size of the NGET network however, and the material differences in costs across it, the revenues of NGET are adjusted on a zonal basis rather than by using a single £/MW revenue driver.

For each zone, a profile of generation and demand consistent with the baseline capital expenditure allowances has been determined. A full-scale adjustment at the end of the price control period is then undertaken as a one-off adjustment to future revenues. As with the incentives across the generality of capital expenditure, NGET is exposed to 25 percent of the differences (either way) between what has been spent and the adjusted level of the allowances.

The revenue driver adjustment is calculated at two levels. Firstly, reflecting the local infrastructure costs incurred (or avoided) in connecting more (or less) MW of new connections than assumed in the baseline. Secondly, reflecting the wider network infrastructure impacts of changes in the extent to which there is surplus generation or surplus demand in each zone. Table 9.2 of the document sets out the final proposals:

Table 9.2 NGET revenue driver parameters (£000 per MW)

	Local	Surplus	Deficit
South & South West	15	0	20
Thames Estuary	15	60	0
London	60	0	250
South Wales	15	25	20
East of England & Home counties	10	65	15
West Midlands	5	0	40
East Midlands	5	55	10
North West & North Wales	30	45	0
Yorkshire & Lincolnshire	15	60	0
North East	15	50	0

A separate revenue driver exists for changes in the transfer capability across the network boundary between Scotland and England. In the event that a change is determined by the Authority as being made, the revenue driver takes the value of £275,000 per MW.