

CONCLUSIONS REPORT

Modification Proposal to the Connection Charging Methodology

CCM-M-04

**Implementation of Changes Required for CAP012
“Procedure for Renewal of NGC (Connection) Assets”**

19 December 2002

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1. INTRODUCTION

A consultation document for modification proposal CCM-M-04 was issued on 11 November 2002. The document set out for consultation National Grid's proposed modification to the Connection Charging Methodology to take account of the CUSC Amendment CAP012: "Procedure for Renewal of NGC (Connection) Assets".

The modification proposal suggested some revised text for the Statement of the Connection Charging Methodology which would reflect the change to the charging methodology. The proposed revised text can be found in Appendices 2 to 4 to this document. Comments on the modification proposal were invited by 9 December 2002.

2. TERMS OF THE ORIGINAL PROPOSED MODIFICATION

<p>Description of proposed modification to the Connection Charging Methodology</p> <p>In line with the Authority's decision on CAP012: Procedure for Renewal of NGC (Connection) Assets, it is proposed to modify the Connection Charging Methodology to reflect the new process and to remove the default charge for assets operating beyond their Replacement Period.</p>
<p>Explanation of the issue</p> <p>Historically, National Grid has levied a default charge to cover any depreciation charges that would be incurred on a new asset which is replaced beyond the expiry of the Replacement Period (without notification upon the expiry of the Replacement Period) without agreement on charging with the User.</p> <p>The establishment of an enduring process for assets operating beyond their Replacement Period, as a result of the CAP012 Amendment, removes the requirement to levy the default charge, and also removes the distinction between asset replacement pre and post the expiry of the Replacement Period.</p> <p>The new arrangements will require National Grid and the User(s) to reach agreement on the asset replacement, and charging for the new assets cannot commence until the agreement is in place. This process removes the need for the default charge and provides a greater level of transparency.</p> <p>In line with the CUSC Alternative Amendment (A), National Grid will be required to provide, where practical and prudent and with regard to the confidential nature of any relevant information, its rationale behind the decision to asset replace. This information should include any wider network factors that were considered, details of the physical condition of the NGC Asset to be replaced, information regarding any alternatives to asset replacement considered by NGC, and any other relevant information in NGC's possession.</p>
<p>Justification for proposed modification</p> <p>To better meet the Relevant Objectives in Licence Condition C7A 5(c) of ensuring National Grid properly takes account of the developments in its Transmission Business.</p>
<p>Suggested alternatives</p> <p>None.</p>
<p>Implementation date</p> <p>1 April 2003.</p>
<p>Proposed changes to the Statement of the Connection Charging Methodology</p> <p>It is proposed that Chapter 2 of the Statement of the Connection Charging Methodology is modified to remove the default charge for assets operating beyond</p>

their Replacement Period.

It is also proposed that Chapter 7 of the Statement of the Connection Charging Methodology is modified as indicated in Appendix 2, to reflect the revised arrangements associated with CAP012.

Finally, as a consequence of the changes to Chapter 2, it is proposed to add a new definition to the Glossary of the Statement as indicated in Appendix 3.

Impacts on existing Connection charges

Connection assets that are operating beyond their current Replacement Period will not have the 2.5% default charge levied on Users.

Impacts on other Industry Documents

There is no impact on other industry documents.

3. RESPONSES TO THE MODIFICATION PROPOSAL

Comments and views were invited on all the issues raised in the Modification Proposal up to 9 December 2002. National Grid received eight responses, which are included in Appendix 1.

All of the eight responses supported the proposed charging methodology modification, although some issues were raised as detailed below.

Definition of Depreciation Period

One of the respondents expressed concern that the definition of "Depreciation Period" provided in the consultation document does not make it clear that in the event that there is no explicit agreement to any other period the default would be taken to be 40 years. The response suggested that this could be clarified by extending the definition with the sentence: *"Unless otherwise specified this will be 40 years"*.

National Grid agrees with the principle of this suggestion and has incorporated a clarification into the proposed revised text as detailed below in section 4 of this Report.

Timing of Proposals

One respondent stated that they felt that the proposed change to the Connection Charging methodology and the CUSC CAP012 amendment should be proposed in parallel before consultations have closed under the governance arrangements of either the CUSC or the Charging Methodologies in order to give a complete picture.

Throughout both the CUSC and the Connection Charging Methodology modification processes, National Grid has ensured that both workstreams are fully aware of the implications and progress of the other. Furthermore, in National Grid's document entitled "Review of the Charging Methodology for Assets Operating Beyond the End of Their Replacement Period - Conclusions Report for a Longer Term Solution" (published April 2002), National Grid confirmed that it would not propose any changes to the Connection Charging Methodology until the result of CAP012 was known:

"The precise details of changes to the methodologies would be the subject of future charging methodology modification consultations. It is anticipated that these modifications would be proposed in July 2002, once the outcome of CAP012 is known".

The CAP012 consultation process closed on 2 September 2002 upon receipt of the Authority's decision document.

4. CHANGES TO THE PROPOSAL IN LIGHT OF REPRESENTATIONS MADE

In light of the responses received, National Grid intends to change the original modification proposal issued on 11 November 2002. The original definition of the term "Depreciation Period" will be modified to include the sentence *"Unless agreed otherwise this will be 40 years"*, as attached in Appendix 4 of this Report.

5. HOW THE PROPOSED MODIFICATIONS BETTER MEET THE RELEVANT OBJECTIVES

The proposed modifications would enable the charging methodologies to better meet the relevant objectives as set out in the transmission licence C7A 5(c):

- (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 the licensee's transmission business.*

The modification would do this by implementing changes to Chapters 2 and 7 of the Connection Charging Methodology to reflect the proposals put forward in National Grid's Alternative Amendment A to CUSC Amendment Proposal CAP012.

6. TIMETABLE FOR IMPLEMENTATION

The consultation document proposed an implementation date of 1 April 2003. National Grid has no reason to change this date and therefore proposes that the connection charging methodology and the Statement of the Connection Charging Methodology be modified from 1 April 2003.

APPENDIX 1 – RESPONSES TO MODIFICATION PROPOSAL

Response from British Energy

“Implementation of Changes Required for CAP012 ‘Procedure for Renewal of NGC (Connection) Assets’”

Further to the above consultation document issued in respect of the above proposed modification, British Energy advise that we SUPPORT the proposal as presented.

We would advise that we have no substantive comments in respect of the proposed modification to the Connection Charging Methodology which flows through from the approval of the above CUSC Amendment Proposal (CAP012).

Response from British Gas Trading Ltd

British Gas Trading (BGT) welcomes the opportunity to comment on the above Connection Charging Methodology modification proposals.

We would like to make the following comments:

CCM-M-04 - Implementation of Changes Required for CAP012 "procedure for Renewal of NGC (Connection) Assets".

We support this proposal. As CAP012 has been approved by the Authority, we see no reason why this proposal should not go ahead.

We believe that removing the current default charge and reaching agreement between User(s) and NGC on asset replacement will bring a greater degree of transparency to these charges.

Response from East Midlands Electricity Distribution plc

Thank you for the opportunity to respond to this consultation document.

East Midlands Electricity Distribution have no comments regarding the proposed modification.

Response from EdF Trading Ltd

Please find below the response from EdF Trading Ltd and EdF (Generation) on your proposed modification to the Connection Charging Methodology to implement the changes required for CAP012.

We note that this proposal is a direct consequence of the need to implement CAP012, specifically to reflect the new process and to remove the default charge. We also note that CAP012 has been approved already, that the proposal is fully consistent with CAP012 and that the changes better meet the Licence Objectives.

We therefore give our support to such changes being made.

Response from Innogy (on behalf of Innogy, Innogy Cogen Ltd, Innogy Cogen Trading Ltd, npower Ltd, npower Northern Supply Ltd, npower Yorkshire Supply Ltd, npower Northern Ltd and npower Yorkshire Ltd)

Whilst we generally welcome this change to the charging methodology we are concerned that the definition of "Depreciation Period" does not make it clear that in the event that there is no explicit agreement to any other period the default would be taken to be 40 years. This could be achieved by extending the definition with the sentence: *"Unless otherwise specified this will be 40 years"*.

Response from LE Group Companies

We agree that this change is required to ensure consistency between connection charges and the planned implementation of CAP012 under the CUSC. However, we believe that any such changes should be proposed in parallel before consultations have closed under either of the governance arrangements in order to give a complete picture.

Response from Powergen

I am responding on behalf of Powergen to the above consultation. We are in agreement with the changes outlined in the document, although we remain of the opinion that British Energy's alternative amendment to CAP012 would have been preferable.

Response from Scottish and Southern Energy plc

SSE agree with this proposal.

APPENDIX 2 – PROPOSED CHANGES TO CHAPTER 2: THE CALCULATION OF THE BASIC ANNUAL CONNECTION CHARGE FOR AN ASSET

Delete current section 2.23 and replace with new 2.23:

2.23 The final charge for each connection asset in year n can be derived from the general formula below. This is illustrated more fully by the examples in **Appendix 2: Examples of Connection Charge Calculations.**

$$\text{Annual Connection Charge}_n = D_n (GAV_n) + R_n (NAV_n) + SSF_n (RPIGAV_n) + TC_n (GAV_n)$$

Where:

For n = year to which charge relates within the Depreciation Period

n	=	year to which charge relates
GAV _n	=	GAV for year n re-valued by relevant indexation method
RPIGAV _n	=	GAV for year n re-valued by RPI indexation
NAV _n	=	NAV for year n based on re-valued GAV _n
D _n	=	Depreciation rate as percentage (equal to 1/Depreciation Period duration - typically 1/40 = 2.5% of GAV)
R _n	=	real rate of return for chosen indexation method (6% for RPI indexation, 7.5% for MEA Indexation)
SSF _n	=	Site Specific Factor for year n as a % (equal to the Site Specific Cost / Total Site GAV)
TC _n	=	Transmission Running cost component for year n (other Transmission Owner Activity costs).

For n = year to which charge relates beyond the Depreciation Period

n	=	year to which charge relates
GAV _n	=	GAV for year n re-valued by relevant indexation method
RPIGAV _n	=	GAV for year n re-valued by RPI indexation
NAV _n	=	0
D _n	=	0
R _n	=	real rate of return for chosen indexation method (6% for RPI indexation, 7.5% for MEA Indexation)
SSF _n	=	Site Specific Factor for year n as a % (equal to the Site Specific Cost / Total Site GAV)
TC _n	=	Transmission Running cost component for year n (other Transmission Owner Activity costs).

APPENDIX 3 – PROPOSED CHANGES TO CHAPTER 7: ASSET REPLACEMENT

Delete heading “Early Asset Replacement”.

Delete current sections 7.1 to 7.3 and replace with new sections 7.1 to 7.2:

7.1 Appendix A of a User's Bilateral Connection Agreement specifies the age (number of complete charging years old), for charging purposes, of each of the National Grid assets at the Connection Site for the corresponding Financial Year. Connection charges are calculated on the assumption that the assets will not need to be replaced until the charging age has reached the duration of the asset's Replacement Period.

If an asset is replaced National Grid will continue to charge for the original asset and make no charge to the existing User(s) for the new asset until an agreement is in place with the User(s) and the original asset's charging age has reached the duration of its Replacement Period.

7.2 When the original asset's charging age has reached the duration of its Replacement Period the User's charge will be calculated on the then Net Asset Value of the new asset. The new asset begins depreciating for charging purposes upon completion of the asset replacement.

Delete heading “Assets Operating after their Replacement Period”.

Delete current sections 7.4 to 7.6.

Delete current sections 7.7 to 7.10 and replace with new sections 7.3 to 7.6:

7.3 There are a number of situations where an asset replacement scheme may involve a change in the voltage level of a User's connection assets. These replacement schemes can take place over a number of years and may involve a long transitory period in which connection assets are operational at both voltage levels.

7.4 These situations are inevitably different from case to case and hence further charging principles will need to be developed over time as more experience is gained. Set out below are some initial generic principles which have been applied to date. This methodology will be updated as experience develops.

7.5 The general principles used to date are to ensure that, in the transitory period of an asset replacement scheme, the User does not pay for two full transmission voltage substations and that the charges levied reflect the Replacement Period of the original connection assets. In addition, in line with paragraph 7.1 above, charges will only be levied for the new assets once the original assets would have required replacement.

For example, National Grid, in investing to meet a future Security Standard need on the main transmission system, may require the asset replacement of an existing 275kV substation with a 400kV substation prior to the expiry of the original assets' Replacement Period. In this case, National Grid will seek to recover the connection asset component via connection charges when the assets replaced were due for asset replacement. Prior to this, the User should not see an increase in charges and

therefore the investment costs would be recovered through TNUoS charges. In addition, if in the interim stage the User has say one transformer connected to the 275kV substation and one transformer connected to the 400kV substation, the charge will comprise an appropriate proportion of the HV assets at each site and not the full costs of the two substations. This would not be the case if the allocation rules as set out in **Chapter 10: The Connection Asset Allocation Process** were strictly applied as the general rule is allocation up to the first transmission voltage. Note that the above described treatment is only made for transitory asset replacement and not enduring configurations where a User has connection assets connected to two different voltage substations.

APPENDIX 4 – PROPOSED GLOSSARY DEFINITION

Glossary

Depreciation Period

In relation to an NGC Asset, for a particular User, the period over which the depreciation element of the connection charge is levied, taking account of the effective charging date and the appropriate Depreciation Period duration. Unless agreed otherwise this will be 40 years.