



Direct Dial: 020-7901-7412

16 January 2003

The National Grid Company, CUSC Signatories and  
Other Interested Parties

Our Ref: UoSCM-M-07

Dear Colleague

**Decision in relation to Use of System Charging Methodology Modification UoSCM-M-07:  
'Proposed change to the TNUoS liability rules for embedded Licence Exemptable Generations  
and Distribution Interconnectors'**

The Gas and Electricity Markets Authority (the 'Authority')<sup>1</sup> has carefully considered the issues raised in the Conclusions Report<sup>2</sup> in respect of the proposed Use of System Charging Methodology Modification-07 ('UoSCM-M-07'), 'Proposed change to the TNUoS liability rules for embedded Licence Exemptable Generators and Distribution Interconnectors'.

The National Grid Company plc ('NGC') submitted the Conclusions Report to the Authority on 19 December 2002 and recommended to the Authority that the proposed modification UoSCM-M-07 should be implemented.

Ofgem has decided not to veto the proposed UoSCM-M-07. The modification will therefore be implemented on 1 April 2003 as set out in the Conclusions Report.

This letter sets out the background to the modification proposal, explains the proposed modification, reports on respondents' views and sets out Ofgem's reasons for its decision.

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<sup>1</sup> Ofgem is the office of the Authority. The terms 'Ofgem' and 'the Authority' are used interchangeably in this letter.

<sup>2</sup> Conclusions Report, Modification Proposal to the Use of System Charging Methodology, UoSCM-07, 'Proposed change to the TNUoS liability rules for Embedded Licence Exemptable Generations and Distribution Interconnectors', dated 19 December 2002.

## Background

Licence Exempt Generators (“LEGs”) can be either directly connected to the transmission system or embedded within a local distribution system. LEGs that are embedded within a local distribution system are referred to as Embedded Licence Exemptable Generators (“ELEGs”). ELEGs can register their meters in the Central Volume Allocation (CVA). This involves becoming a Balancing and Settlement Code (BSC) Party, with the attendant costs and obligations, since these meters must be associated with a Balancing Mechanism Unit (“BMU”). Alternatively, they can register their meters through a licensed supplier in the Supplier Volume Allocation (‘SVA’), in which case their meters must be associated with a Supplier BMU.

Distribution Interconnectors, which are interconnectors to external systems that are connected to a distribution network rather than the transmission network, can also choose whether to register their meters in CVA or SVA.

ELEGs and Distribution Interconnectors that are registered in CVA and who participate in the Balancing Mechanism are liable for TNUoS generation charges. ELEGs and Distribution Interconnectors that are registered in SVA or that do not participate in the Balancing Mechanism are not liable for TNUoS generation charges. Therefore, the current methodology results in the treatment of ELEGs and Distribution Interconnectors dependant on where they are registered and how they choose to trade.

In addition, the existing rules for determining eligibility for “netting off” differ according to how ELEGs and Distribution Interconnectors are registered. Netting off involves deducting the generation metered volume of ELEGs or Distribution Interconnectors from a supplier’s demand metered volume to reduce the supplier’s exposure to the payment of TNUoS charges. ELEGs and Distribution Interconnectors registered in SVA are automatically netted off as they form part of a Supplier BMU. ELEGs and Distribution Interconnectors registered in CVA can contract with one or more suppliers in the same Grid Supply Point (“GSP”) Group to net off. However, they must form part of a Trading Unit with a Supplier BMU, or notify NGC that a netting off agreement exists with one or more Supplier BMUs in that GSP Group in order for NGC to facilitate the netting off. In the case where the ELEG or Distribution Interconnector forms part of a Trading Unit with a Supplier BMU, they can participate in the Balancing Mechanism and still net off. However, in the case where the ELEG or Distribution Interconnector is not in a Trading Unit with a Supplier BMU, they cannot participate in the Balancing Mechanism and still net off.

NGC considers that the current charging rules result in different treatment for physically similar plant depending on contractual and meter registration issues. Furthermore, NGC considers that this differentiation in treatment may not be consistent with the effect on the transmission system of power generated from ELEGs or exported from Distribution Interconnectors at a particular location.

## The Proposed Modification

The modification proposes to modify the methodology for determining the liability for TNUoS charges. All embedded generators capable of exporting less than 100 MW would be exempt from generation TNUoS charges.

In addition, CVA registered ELEGs would be known as "Exempt Export BMUs" and CVA registered Distribution Interconnectors would be known as Derogated Distribution Interconnector BMUs. Exempt Export BMUs and Derogated Distribution Interconnector BMUs would pay, or be paid, demand TNUoS charges on the basis of their metered volumes during the half-hours used in calculating such charges.

If their average half-hourly metered volume over the relevant periods results in a net import, they will be charged the amount of the relevant kW tariff multiplied by the average import. If their average half-hourly metered volume over the relevant periods results in a net export, they will be paid the amount of the relevant kW tariff multiplied by the average export.

Therefore, suppliers who had a netting-off agreement in place with an Exempt Export BMU and Derogated Distribution Interconnector BMU, either within a Trading Unit or through an arrangement facilitated by NGC, will see an increase in their TNUoS demand charges. ELEGs and Distribution Interconnectors who were part of such netting off arrangements will be paid or charged directly.

NGC considered that this modification would facilitate competition in the generation and supply of electricity (Relevant Objective C7A.5(a)<sup>3</sup>) by:

- ◆ Ensuring consistent treatment of ELEGs and Distribution Interconnectors; and
- ◆ Providing a clear framework for charging ELEGs and Distribution Interconnectors.

In addition, NGC believed that the modification took account of developments in the licensee's transmission system (Relevant Objective C7A.5 (c)) by considering the continuing development of the rules for Trading Units as defined under the BSC and would ensure that it did not discriminate unduly between similar classes of users.

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<sup>3</sup> The Relevant Objectives of the Use of System Charging Methodology, as contained in Condition C7A.5 of National Grid Company's Transmission Licence are:

- (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;
- (b) that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs incurred by the licensee in its transmission business; and
- (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.

NGC issued a consultation paper on 11 November 2002 inviting responses from CUSC Parties and interested parties.

### **Respondents' views**

NGC received eight responses to the consultation, of which three supported the modification and the remaining five did not support the modification.

Respondents that commented on generation below 100MW being excluded from generation TNUoS charges were supportive of this change. However, respondents were in disagreement over the proposal to modify the methodology for demand TNUoS charging.

Respondents that supported the modification considered that it would enhance competition because it would make it easier for such generators to access embedded benefits. One respondent suggested that removing the requirement for ELEGs registered in CVA to net off their export with a counterparty possessing sufficient demand in the relevant GSP Group would increase their contracting options. However, this respondent was concerned that the modification may incentivise SVA registered ELEGs to transfer their registration to CVA to an extent that current arrangements may not be able to support.

One respondent, who did not support the modification, considered that it would ensure consistent treatment of ELEGs and Distribution Interconnectors in respect of CVA or SVA BSC Registration. However, this respondent and another considered that the proposal would also provide differential treatment for physically similar plant, depending whether they are connected to the transmission system or a distribution system, and pay generation TNUoS or demand TNUoS charges respectively. This is because CVA registered plant would receive the full TNUoS embedded benefit directly whilst SVA registered plant would have to negotiate a share of the benefit with their supplier. The first respondent suggested that a consistent approach should be developed to the treatment of transmission and distribution charging arrangements whilst the second respondent suggested that this would make suppliers less willing to contract with ELEGs, which would be to the detriment of competition.

Another respondent that did not support the modification considered that only local generation that can be clearly associated with local demand would reduce transmission costs. This respondent considered that this could only be clearly demonstrated by incorporating the ELEG within a demand Trading Unit or by way of NGC facilitating netting off.

The respondents' views are summarised and contained in the Conclusion Report in respect of UoSCM-M-07.

## **NGC's view**

In regard to respondents' views that the modification would introduce a cross subsidy, NGC suggests that it is appropriate to recognise the impact of generation in reducing local demand so that the charges faced by that generation and demand reflect the costs they impose on the transmission system or the benefits that they bring. In this respect, the modification does not change the current charging methodology. However, the modification ensures that parties who are treated as negative demand for charging purposes receive that payment direct, rather than being required to specify a contractual relationship with another party.

In regard to discrimination between CVA and SVA registered ELEGs, NGC does not have any direct contractual relationship with SVA registered ELEGs, and so cannot charge or pay them directly. NGC suggests that ELEGs will need to assess the comparative benefits of registering in CVA or with a supplier and make their own choice, but the proposed modification would allow them to make this decision on the basis of a clear charging methodology.

In regard to discrimination between transmission and distribution connected ELEGs, NGC consider that any ELEG connected directly to the transmission system is making use of the transmission system. Therefore, it is appropriate to charge them generation TNUoS charges since the output of the generator should not be considered as reducing any local demand.

NGC disagrees with the view that generation needs to be clearly associated with a local demand through a Trading Unit or contractual agreement in order to be treated as netting off local demand. NGC consider that the issue is whether the ELEG has an effect on the transmission costs, not the form of its contractual relationship with a supplier.

NGC did not propose any further changes to the modification after receiving responses to the consultation and continues to consider that the modification proposal would better facilitate the Relevant Objectives C7A.5 (a) and (c), as outlined above. NGC, therefore, recommended to the Authority that modification proposal UoSCM-M07 should be made and implemented from 1 April 2003.

## **Ofgem's view**

Ofgem considers, having had regard to its statutory duties, that modification proposal UoSCM-M-07 would better facilitate achievement of the Relevant Objectives of the Use of System Charging Methodology.

In considering the modification, Ofgem has found it helpful to distinguish between the "underlying" charging basis i.e. whether or not generation is treated as negative demand, and the final "effect" i.e. what proportion of that charging basis is borne by a participant.

It is clear that the modification brings consistency to the underlying charging basis for SVA and CVA registered ELEGs and Distribution Interconnectors but it does not bring consistency to the final effect, since for SVA registered ELEGs and Distribution Interconnectors this will continue to depend on negotiations with their suppliers.

As NGC points out, it does not have a contractual relationship with SVA registered ELEGs and Distribution Interconnectors and hence the Use of System Charging Methodology cannot be used to address this issue. NGC considers, and Ofgem accepts, that, as Condition C7C (3) of its transmission licence states that it should not make charges on (or make payments to) authorised electricity operators whose contract does not provide for them to receive the service for which the charge is being levied, it would not be in a position to levy charges against SVA registered ELEGs.

It is important to note that, in deciding upon any modification, Ofgem has to consider not whether the modification represents the best possible method for achieving the Relevant Objectives but merely whether the modification would better facilitate their achievement. That is, Ofgem can only consider the impact of the modification that comes to it for determination. Consequently, it would not be appropriate to veto a modification because it did not address all aspects of an issue, if the issues that were addressed would lead to the better facilitation of some, or all, of the Relevant Objectives.

Nonetheless, during its consideration of modification UoSCM-M-07, Ofgem requested, and received, confirmation from NGC that it believes the modification does not discriminate between CVA and SVA ELEGs, since both CVA and SVA ELEGs will be treated as negative demand. In this respect, the modification will remove the current possibilities for the “underlying” treatment of SVA and CVA registered ELEGs and Distribution Interconnectors to be different, with some facing generation TNUoS charges and others being treated as negative demand

Ofgem also requested NGC to confirm whether embedded generation would be treated consistently with demand. NGC stated that embedded generation not liable for generation charges would be treated as equal and opposite to demand for the purposes of determining demand charges.

On the basis of these responses, and consideration of the general issues involved, Ofgem considers the modification better meets Relevant Objective C7A.5 (a) by ensuring consistent treatment of Embedded Licence Exemptable Generators and Distribution Interconnectors and by providing a clear framework for charging for Embedded Licence Exemptable Generators and Distribution Interconnectors.

The removal of the potential for physically similar plant to face different charges at the underlying level as a result of all ELEGs and Distribution Interconnectors under 100 MW being

treated as negative demand, also better facilitates the achievement of Relevant Objective C7A.5 (b) in that the charging basis for all these plant will be the same. Ofgem considers this to be true even though the final split of the charges may vary between CVA and SVA registered plant depending on the outcome of negotiations between SVA registered plant and their suppliers.

### **The Authority's Decision**

The Authority has therefore decided not to veto the proposed UoSCM-M-07. The modification will therefore be implemented on 1 April 2003, as set out in the Conclusion Report.

Please contact me on the above number if you have any queries in relation to the issues raised in this letter or alternatively contact Richard Ford on 020 7901 7411.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sonia Brown', with a stylized initial 'S'.

**Sonia Brown**

**Director, Electricity Trading Arrangements**

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