Direct Dial: 020-7901-7412

19 December 2003

National Grid Company, CUSC Signatories and
Other Interested Parties

Our Ref: CCM-M-07

Dear Colleague

Decision in relation to Connection Charging Methodology Modification-07: "Implementation of "PLUGS" – Change to Connection Boundary and associated removal of Land Charges and Type B Termination Charges and Change to Calculation of Site Specific Maintenance Charges"

The Gas and Electricity Markets Authority (the 'Authority')[1] has carefully considered the issues raised in the Conclusions Report[2] in respect of the proposed Connection Charging Methodology Modification-07 ('CCM-M-07') "Implementation of "PLUGS" – Change to Connection Boundary and associated removal of Land Charges and Type B Termination Charges and Change to Calculation of Site Specific Maintenance Charges".

National Grid Company plc ('NGC') submitted the Conclusions Report to the Authority on 21 November 2003 and recommended to the Authority that the modification proposal CCM-M-07 should be made.

Ofgem has decided **not to direct** that the proposed CCM-M-07 may not be made. The modification will therefore be implemented on 01 April 2004 as set out in the Conclusions Report.

This letter sets out the background to the modification proposal, and the Authority's reasons for its decision.

This letter constitutes the notice by the Authority under section 49A of the Electricity Act 1989.

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

[2] "Conclusions Report to the Authority, Modification Proposal to the Connection Charging Methodology, CCM-M-07, Implementation of "PLUGS" – Change to Connection Boundary and associated removal of Land Charges and Type B Termination Charges and Change to Calculation of Site Specific Maintenance Charges", 21 November 2003. This document is available electronically from http://www.nationalgrid.com/uk/indinfo/charging/mn_modifications.html

Background

The Connection Charging Methodology details how NGC recovers its costs and a reasonable rate of return for the provision of assets to connect users to the transmission system. Currently, connection assets relate to assets which are installed to enable a connection of one user or a defined class of users.

The Use of System Charging Methodology details how NGC recovers the costs of providing a transmission system for the bulk transfer of electricity between connection points and to provide transmission system security. The amount that NGC can recover via use of system charges is regulated by NGC's transmission owner price control. The current price control period runs from 1 April 2001 until 31 March 2006[3].

NGC is required by its transmission licence to keep its Connection Charging Methodology and Use of System Charging Methodology (the 'Charging Methodologies') under review at all times[4]. NGC must bring forward proposals to modify its Charging Methodologies that it considers will better facilitate achievement of the relevant objectives set out under the transmission licence[5]. In addition, the transmission licence sets out that NGC cannot discriminate between any persons or class or classes of persons in providing use of system or in carrying out works for the purpose of connection to the transmission system[6].

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[3] Ofgem has recently published its view that it is minded to extend NGC's transmission owner price control until 31 March 2007 to line up with the price control for Transco, the transmission owner for the national gas transmission system. Further details are available from Ofgem's webpage on http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/5115_timetable_reviews_openlet_18nov03.pdf

[4] See Conditions C7A.1 and C7B.2 of NGC's transmission licence.

[5] The Relevant Objectives of the Use of System Charging Methodology, as contained in Condition C7A.5 of the 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.

The Relevant Objectives of the Connection Charging Methodology, as contained in Condition C7B.11 of NGC Company's transmission licence (the "transmission licence"), are:

(a) the objectives referred to in paragraph 5 of standard condition C7A (Use of System Charging Methodology), as if references therein to the use of system charging methodology were to the connection charging methodology; and
(b) in addition, the objective, in so far as consistent with sub-paragraph (a), of facilitating competition in the carrying out of works for connection to the licensee's transmission system.

[6] See Condition C7C of NGC's transmission licence

NGC has reviewed its Charging Methodologies in consultation with users. NGC initiated the review in February 2002. The review has progressed through workshops, discussion papers, industry consultations and seminars.

The timing and progression of the review was informed by specific commitments which NGC made to Ofgem in March 2003, including reviewing and where appropriate bringing forward proposals for implementation in April 2004 in respect of:

1. charges for the provision of a connection to the transmission system that represent the cost of connection attributable to a single user, and that encourage competition in the provision of connections; and

2. the investment cost signals given by Transmission Network Use of System ('TNUoS') charges, specifically looking at the marginal costing method and the locational signals provided by the charges[7].

In September 2002, NGC published options for changing the Connection Charging Methodology to address commitment one above. NGC set out different proposals for revising the boundary between connection and infrastructure for the purpose of setting and recovering NGC's regulated transmission charges. NGC progressed two of these options following feedback at a September 2002 workshop.

Ofgem published an open letter to the industry on 9 June 2003 inviting views on any issues in relation to NGC's transmission charging review. Twelve users responded to the letter and all responses can be found on Ofgem's webpage[8].

In July 2003 NGC issued a consultation document entitled "Initial Charging Methodologies Consultation[9]". In the document, NGC proposed to change the Connection Charging Methodology to ensure that all assets which can be shared are charged for via use of system charges rather than connection charges. NGC also proposed to modify the Use of System Charging Methodology to introduce a DC load flow model for calculating use of system charges. NGC invited views from users by 1 August 2003.

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[7] All of NGC's commitments are listed in "NGC system operator incentive scheme from 1 April 2003 – 31 March 2004: Final Proposals and Statutory Licence Consultation, Ofgem, March 2003", at paragraphs 6.14-6.18. This document is available electronically from http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/2545_16so_incentives.pdf

[8] See Ofgem's webpage at the following address: http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/electradingarrangements&levelids=,1_3687#top3687

[9] This document is available from NGC's webpage at http://www.nationalgrid.com/uk/indinfo/charging/pdfs/Initial_Charging_Meths_consultation_July_2003_FINAL_(z6).pdf

In light of respondents' views, NGC issued a consultation on CCM-M-07 and UoSCM-M-10[10] on 12 September 2003 to modify its Connection Charging Methodology and its Use of System Charging Methodology. NGC invited responses by 10 October 2003.

NGC also raised Connection and Use of System Code ('CUSC') Amendment Proposals CAP052 "Removal of Land Charges" and CAP053 "Reconciliation of Site Specific Maintenance Charges"[11] for consideration at the 26 September 2003 CUSC Amendments Panel meeting. CAP052 and CAP053 propose consequential changes to the CUSC if CCM-M-07 were implemented[12].

On 13 October 2003, Ofgem issued a consultation on potential changes to NGC's transmission licence. In the consultation, Ofgem highlighted that NGC's ability to collect allowed revenues would be affected if CCM-M-07 were implemented. In addition, Ofgem set out that NGC would need to make repayments to users that for example made capital contributions or opted for accelerated depreciation for their connection assets (collectively referred to as resolving "legacy issues"). Ofgem set out options for addressing recovery of costs arising from legacy issues, and invited views from all interested parties by 27 October 2003.

On 19 November 2003, in light of respondents' views, Ofgem issued a statutory consultation to modify NGC's transmission licence to address issues that would arise if CCM-M-07 were to be implemented. This consultation closed on 17 December 2003.

The proposed modification

The proposed modification to NGC's Connection Charging Methodology has four key elements:

- **Change to connection boundary:** All assets which are shared or could be shared will be charged for via use of system charges rather than connection charges to which a different methodology applies. Sharing of transmission assets would therefore only occur within use of system and not connection. This means that substations (and associated site infrastructure and land), generation only spurs, and shared transformer circuits will be charged for via use of system charges.

[10] NGC's consultation documents on both CCM-M-07 'Implementation of "PLUGS" – Change to Connection Boundary and associated removal of Land Charges and Type B Termination Charges and Change to Calculation of Site Specific Maintenance Charges' and Use of System Charging Methodology Modification 10 ('UoSCM-M-10') 'Proposal to amend the methodology for calculation of locational TNUoS tariffs' can be found on http://www.nationalgrid.com/uk/indinfo/charging/mn_modifications.html. Ofgem's decision in relation to UoSCM-M-10 has been issued concurrently with this letter.

[11] Details on these Amendment Proposals can be found on NGC's webpage at www.nationalgrid.com/uk/indinfo/cusc .

[12] The Authority has received the Final Report in relation to these Amendment Proposals, and will be making its decision in due course.

- **Removal of land charges:** All current connection assets that attract a charge for land will be charged for via use of system charges. Land charges will therefore be removed from the Connection Charging Methodology.

- **Removal of type B termination charges:** Type B termination charges are currently levied against users that are departing a connection site with shared assets. The proposed change to the connection boundary will ensure that assets which are shared or have the potential to be shared are charged for via use of system charges. Type B termination charges will therefore be removed from the Connection Charging Methodology.

- **Change to calculation of site specific maintenance charges:** Currently, NGC apportions the total forecast maintenance costs to users based on a three year historic average of costs at the specific sites. For assets that are less than three years old, an assumed fixed maintenance factor of 0.5% of Gross Asset Value is applied. With the proposed modification NGC would charge users site specific maintenance based on cost pass through of actual maintenance costs incurred in the relevant year. The charge would also include a proportion of maintenance overheads such as costs related to maintenance planning and management activities. The maintenance overheads would be apportioned between connection and use of system assets relative to the Gross Asset Value of these assets. Indicative site specific charges will be based on a flat percentage of the Gross Asset Value (estimated at 0.5% for the year 2004/05). There will then be a one-off reconciliation against actual outturn charges in July of the year following the year the charge relates to.

Respondents' views

NGC received 22 responses to its 12 September 2003 consultation on CCM-M-07. Two of these responses were confidential. Of the non-confidential respondents, 11 supported the proposed modification either in principle or in full and 8 respondents did not support it. The remaining respondent did not express a firm view for or against the proposed modification.

Respondents supporting the proposed modification agreed that it would benefit competition in generation by removing some of the risks associated with sharing at shared connection sites. These respondents considered the change would make it easier for generators to enter and exit the market and simplify the charging arrangements.

Four respondents considered the proposed modification would offer enhanced transparency in charge setting. Another respondent considered that charging for connection assets via use of system charges would simplify the process for renewing assets as NGC owned assets would be in NGC's control.

Two of the respondents supporting CCM-M-07 considered it would lead to better cost reflection in NGC's charges.

Six respondents considered that CCM-M-07 would not be beneficial to competition in generation and supply. One of these respondents believed that competition would be hindered

because the cost of new connections and system reinforcements would be charged to existing users who had already paid towards their own connection charges. Another two respondents considered competition would not be facilitated by the abrupt change to both connection and use of system charges. One respondent considered that the delay in making revised transmission charges available to Distribution Network Operators ('DNOs') would adversely affect DNO customers and be harmful to competition.

One respondent considered that CCM-M-07 would discriminate against users with old connection assets. The respondent considered that users with old assets that are not replaced would face a higher use of system charge without any benefits from a new asset.

Some respondents considered CCM-M-07 would reduce competition in supply because of the resultant increase in use of system charges. These respondents considered the increase in use of system charges would have a detrimental impact on suppliers who offer aggregated prices and products based on load management at the Triad[13].

Some respondents commented that the proposed modification would not improve the cost reflectivity of NGC's Charging Methodologies. Two respondents considered that CCM-M-07 would result in a lack of incentive for users to minimise the costs of individual connections. This could result in previously uneconomic connections being built and paid for by all users.

One respondent considered that removing type B termination charges could remove the incentive on users to ensure efficient design and use of new connections.

Two respondents were concerned that the proposals to change the calculation of site specific maintenance charges would lead to volatile and unpredictable charges. One respondent considered NGC should consult further with users, and complete a cost-benefit analysis of the proposals before taking them further.

One respondent considered that CCM-M-07 would lead to discrimination in the treatment of shared sites and non-shared sites. This respondent asked NGC to demonstrate that an asset could never be shared at any point in the future or to allow the User to deem that asset shareable.

One respondent considered that the proposed modification would lead to charges to different classes of users not directly reflecting the costs of the service. The respondent considered that this would be in breach of NGC's licence condition C7C which relates to non-discrimination in the provision of use of system or in carrying out works for connection. The respondent considered that this would particularly be the case with charging for generation only spurs via use of system charges.

[13] The Triad is a short hand way to describe the three half hour periods of the highest demand on the transmission system between November and February. The periods must be separated from each other by at least 10 clear days.

Two respondents were concerned that the proposed modification would lead to an increase in TNUoS charges for renewable and embedded generators without any corresponding decrease in connection charges. One respondent considered that this would lead to a cross-subsidy flowing from embedded to transmission connected generators.

One respondent considered that there was not enough information available to properly consider the modification proposal. Another respondent said that the proposed modification was so complex that it was impossible for industry parties to assess the implications of the proposals on their businesses.

Seven respondents commented on the interaction between the modification proposal and the British Electricity, Trading and Transmission Arrangements ('BETTA') project. Four of the respondents that supported the modification proposal in principle, considered that these changes should not be implemented before BETTA. Two respondents believed that NGC should not progress the modification proposal until BETTA proposals have been consulted upon.

Three respondents were concerned that the reductions to DNOs' transmission connection charges would not be passed through to customers via Distribution Use of System Charges.

One respondent was concerned that NGC had not established the principles for how to address legacy issue. The respondent considered that firm price connection agreements should remove any exposure to year on year changes to charges, but that when the Charging Methodologies change significantly, firm price agreements should be adjusted in a manner consistent with the new arrangements. Another respondent commented that refunds of capital contributions could result in higher charges to all users.

One respondent considered that any changes to the Charging Methodologies should be fully supported by a regulatory impact assessment. This respondent also believed that the current governance arrangements for the Charging Methodologies should be made more inclusive.

NGC's Conclusion Report for CCM-M-07 contains a summary of respondents' views and the full text of non-confidential responses.

NGC's view

NGC's recommendation

NGC did not make any changes to the proposed modification in light of respondents' views. NGC recommended to the Authority that CCM-M-07 should be implemented for 1 April 2004.

NGC considered that the proposed changes would better facilitate the relevant objective of facilitating effective competition in the generation and supply of electricity and (so far as is consistent therewith) to facilitate competition in the sale, distribution and purchase of electricity. NGC also believed that the parts of the proposed modification relating to land charges and

termination charges would lead to better facilitation of the relevant objective of taking account of developments in its transmission business.

NGC was of the opinion that a modification to its transmission licence to adjust its allowed revenue would be necessary if CCM-M-07 were implemented. NGC considered that this would be necessary to ensure that the proposed modification leads to charges which reflect, as far as is reasonably practicable, the costs incurred by NGC in its transmission business.

NGC believed that the proposed changes to site specific maintenance charging would lead to better facilitation of the relevant objective of ensuring that charges as far as is reasonably practicable reflect the costs incurred by NGC in its transmission business.

NGC also considered that the proposed modification is compliant with condition C7C of its transmission licence, requiring it not to discriminate between any persons or class or classes of persons in providing use of system or in carrying out works for the purpose of connection to the transmission system.

In the conclusions report for CCM-M-07, NGC provided a rationale for each of the specific components of the proposed modification. This rationale was also included in NGC's 12 September 2003 consultation document. The section below provides a summary of NGC's rationale.

Rationale for the changes to the connection boundary

NGC considered that the sharing arrangements for connection assets could restrict competition as charges could be volatile and vary depending on the actions of other users or those of NGC. For example, an existing user's connection charge could change due to the requirements of a new user joining a connection site. Similarly, termination charges at shared sites may be unpredictable for the departing user and the charges for the remaining users may be similarly uncertain. Each user's charge may depend on the actions of others. In an extreme example, a longstanding user may be forced to pay termination charges for relatively new assets that were only installed recently due to the connection of a second user. In addition, due to wider system developments, NGC may decide that the substation to which a user is connected should be upgraded to a higher voltage. The part of the user's connection charge that relates to the substation would therefore increase due to system considerations rather than to reflect new requirements from the user.

NGC was of the view that there are economic benefits in sharing connection assets. However, NGC considered that substation assets and all other shareable assets should be removed from connection charging to facilitate competition by ensuring that users are reasonably protected against investment decision driven by wider system developments and the decisions of other users. NGC believed that the proposed change would result in the retention of sharing incentives and with the benefits and disadvantages of asset sharing in general being realised by all infrastructure users rather than by individual connecting parties.

NGC considered that there are three main issues with the current treatment of generation only spurs:

- **Barrier to new entrants:** A new generator connecting via a spur line, would be charged for the majority of the spur, including an allocation of any switchgear at the remote end of the spur. A spur connected generator would therefore incur significantly higher connection charges than a non-spur connected generator. Remote and local transmission circuitry is also not treated in a consistent manner. The connection of a generator without a spur may lead to significant infrastructure upgrades. The costs of these infrastructure upgrades would be reflected via the use of system charge. Another generator of comparable size connecting via a spur line, may not cause any wider infrastructure upgrades but the cost of the spur line may be of a similar magnitude as the cost of the infrastructure upgrade caused by the other connecting generator. If the additional circuits required for the two cases both had been charged for via use of system charges, a consistent cost reflection could have been achieved.

- **Utilisation of existing spur lines:** Existing generation only spur lines may be underutilised because of the significantly higher cost of connecting to them.

- **Network interaction:** The cost of connecting via a spur line is also dependent on the overall network configuration at the point the generator wants to connect. The cost of a spur line would for example in general be higher if the generator is connected via a remote substation rather than a turn-in, tee, or a re-route of existing circuitry.

To conclude, NGC considered that the current treatment of generation only spurs could restrict competition and that in order to ensure consistent treatment of all transmission circuitry generation only spurs should be charged for via use of system charges.

Rationale for the changes to land charges

NGC believed that land charges will no longer be required, as the proposed changes to the connection boundary would result in substations and associated site infrastructure being charged for via use of system charges. In addition, this change would ensure consistent treatment of pre and post-Vesting assets. Currently, the costs of land for pre-Vesting connection assets are recovered via use of system charges, whereas the costs of purchasing land for post-Vesting connection assets is recovered via the connection charge. Removing land charges from connection charging would therefore ensure consistent treatment of pre and post-Vesting assets.

Rationale for the changes to termination charges

NGC considered that type B termination charges, which relate to shared connection assets, should be removed from the Connection Charging Methodology to reflect that there will be no shared or shareable connection assets.

Rationale for the changes to site specific maintenance charges

NGC noted that some users considered that the current methodology for calculating the site specific maintenance charge is complex and non-transparent leading to a barrier to contestability. In addition, NGC considered that administering the current process is onerous as it needs to keep records of three years of costs in a consistent manner. There is also a requirement for manual calculation to handle any changes to connection assets, such as the inclusion of a new asset which is only in service for one of the three years that the charge is based on. NGC believed that the change to site specific maintenance charge would lead to better cost reflection and better facilitate competition by improving the possibilities of contestability in maintenance.

NGC's comments on respondents' views

NGC also provided some comments in response to the views received from users during the consultation on CCM-M-07. The section below sets out a summary of NGC's comments on respondents' views. A full description of NGC's comments on respondents' views can be found in the conclusion report for CCM-M-07.

NGC did not agree with those respondents that considered the proposed modification would not facilitate competition for the following reasons. NGC believed that the changes would ease the restrictions on competition by removing the complex sharing rules and would also reduce the potential volatility caused by the sharing rules. In addition, NGC believed that moving the connection boundary would protect users from the risk of wider system developments impacting on connection charges. NGC considered that the change would result in the retention of sharing incentives and with the benefits and disadvantages of asset sharing in general being realised by all infrastructure users rather than by individual connecting parties. NGC was of the opinion that existing users liable for connection and infrastructure charges would see the benefit of reduced risk of 'saw-toothed' connection charges that currently arise with asset replacement. NGC considered that removing this risk would promote competition. Finally, NGC considered that it has given as much information as possible to DNOs to assist them in setting their charges for 2004/05 and therefore that there would be no detrimental impact on competition.

NGC disagreed that the proposal would discriminate against generators with older assets as the primary driver for asset replacement is the condition of the asset. NGC considered that there is therefore a degree of unpredictability, especially in the medium to longer term regarding planned or unplanned asset replacement. NGC considered that sharing the uncertainty associated with asset replacement with all users by charging for shareable assets via use of system charges would facilitate competition.

NGC noted the concerns regarding increases in costs and risk to suppliers. However, NGC did not consider that the proposed modification would have a negative impact on competition in supply as all suppliers will be exposed to the same cost in any given area. NGC also believed that any increase in demand TNUoS charges would increase the market for such products and provide additional opportunities for suppliers.

NGC did not agree that the proposal is not cost-reflective as the Use of System Charging Methodology would ensure cost-reflective charging for assets which will be charged for via use of system rather than connection charges. NGC noted that the proposed changes to its Use of System Charging Methodology contained in UoSCM-M-10 would make charges more cost-reflective. In addition, NGC was of the opinion that the changes to the calculation of site specific maintenance charges will provide increased transparency and cost reflectivity.

NGC did not agree that the proposed modification would result in the connection process becoming economically inefficient. NGC considered that there are number of reasons supporting this view:

- NGC has a licence obligation to maintain and develop an efficient and economic transmission system.

- NGC's capital investment decisions are driven by the requirement to maintain the transmission system to meet the appropriate licence standards. Unless there is a change to these standards, there can be no change to the level of investment required to maintain compliance.

- NGC also responds to economic incentives put in place by its transmission price control to develop an economic and efficient transmission system. Any increase in investment costs would have to be agreed when the price control is set by Ofgem.

- NGC considers that locational signals currently provided via connection charges will appropriately transfer into use of system charges. This would ensure that users will still receive locational signals informing their decisions about where to locate on the transmission system.

NGC also disagreed with the view that removing type B termination charges would reduce the incentive on users for efficiency in new connections for the same reasons it considered the connection process would not become economically inefficient (see bullet points above).

NGC agreed that there is a potential for increased volatility of site specific maintenance charges for users. However, NGC considered the proposed modifications would lead to increased cost reflectivity and improve the potential for contestability. NGC considered that these effects would outweigh the potential increase in volatility of the charge.

NGC considers that the proposed changes to the calculation of site specific maintenance charges would better facilitate achievement of the relevant objectives of the Charging Methodologies. NGC noted that its own costs related to administering the site specific maintenance charging process should reduce, and that it had not received any information from users indicating that they would have significant implementation costs that would prove prohibitive to facilitating competition.

NGC disagreed that recovering the costs of generation only spurs via use of system charges would be discriminatory as users with peripheral connections would see significant differences in the nodal charges provided by the TNUoS charging methodology. Applying the zoning criteria, this would result in the generator either being included within a redefined small, more expensive generation zone or potentially in its own zone. NGC considered that charging for generation only spurs via use of system charges would result in a more consistent, cost-reflective charging structure for transmission circuits and overhead lines.

NGC agreed that large embedded generators may experience an increase in use of system charges without an associated reduction in connection charges due to the pass through mechanism employed by DNOs. NGC considered that it is appropriate for all generation to pay use of system charges to reflect infrastructure costs. In addition, small embedded generators that are capable of exporting less than 100MW onto the system and are registered in Central Volume Allocation who have a net export over the Triad would be liable for negative TNUoS demand charges. NGC therefore believed that an increase in TNUoS demand charges would be beneficial to this category of embedded generation. Finally, NGC considered that its proposed transmission connection charges are not discriminatory and that they better meet its relevant licence objectives.

NGC did not agree that there had been insufficient information to support the modifications. NGC pointed out that it has conducted a review process that has been open and accessible to users including workshops, regular updates via the Transmission Charging Methodologies Forum, and a number of consultations with users. NGC also considered that it has provided analysis of indicative charges flowing from the proposed changes. Finally, NGC highlighted that all documentation from the workshops, consultations and Transmission Charging Methodologies Forum meetings is available from NGC's charging website.

In response to the concerns raised regarding interaction with BETTA, NGC considered that the obligations placed upon it under the transmission licence require it to bring forward proposals to review its charging methodologies which will better facilitate the relevant objectives. NGC believed that this obligation must be discharged regardless of other developments, such as the development of BETTA.

In response to the concerns raised over the treatment of legacy issues, NGC considered that it would not be possible to provide any meaningful detail on principles for how to address non-standard agreements without compromising the confidentiality of those agreements. NGC said that it intends to review specific agreements on a bilateral basis with the parties concerned to achieve an equitable solution agreeable to all parties concerned.

In summary, NGC considered that the proposed modifications (CCM-M-07 and UoSCM-M-10) would facilitate competition whilst retaining cost reflectivity.

Ofgem's view

Ofgem has decided not to veto NGC's proposed changes to the Connection Charging Methodology as set out in CCM-M-07. In making its decision, Ofgem has had regard to its statutory duties set out in the Electricity Act 1989, the Relevant Objectives of the Connection Charging Methodology, the responses to NGC's consultations on CCM-M-07 and UoSCM-M-10, the responses to Ofgem's open letter on transmission charging issues, and responses to Ofgem's consultation to make consequential changes to NGC's transmission licence if CCM-M-07 were implemented.

Ofgem considers that the proposed change together with UoSCM-M-10 will help ensure non-discriminatory, cost-reflective arrangements for use of NGC's system and in the carrying out of works for connections. In Ofgem's view, the changes to NGC's Charging Methodologies should further facilitate competition in generation and supply and additionally competition in carrying out works for connections to the system. The section below discusses each of these issues in more detail and finally concludes on other relevant considerations, in particular BETTA and the need for GB consultation.

The transmission licence obligation of ensuring non-discrimination in the provision of use of system and in the carrying out of works for connection.

In its recommendation, NGC considered that CCM-M-07 was compliant with its licence condition in relation to non-discrimination. Ofgem considers that CCM-M-07 is an improvement on the existing arrangements in this respect. Under the present arrangements, potentially discriminatory charges for connection could arise. This is because a user's connection charge may depend on other users' requirements for shared assets and the particular configuration of the transmission system at the point of connection whereas all users are currently charged by NGC for wider transmission upgrades.

Ofgem considers that CCM-M-07 will ensure that there are non-discriminatory arrangements for connection to and use of the system helping to ensure that all users are on a level playing field.

Ofgem does not agree with the respondent that considered that the proposed modifications (UoSCM-M-10 and CCM-M-07) discriminate against embedded renewables. Embedded generators that are liable for use of system charges will be treated in the same manner as transmission connected generators and be subject to charges that will better reflect the costs of providing the transmission system than at present.

The Relevant Objective that compliance with the connection charging methodology results in charges which reflect the costs incurred by NGC in its transmission business.

Ofgem considers that the proposed modification will ensure that the costs of all assets that are shareable are charged to all users, as these assets ultimately can benefit all users of the transmission system. Ofgem considers that this will improve the cost reflection in NGC's charges. Cost-reflective charges encourage efficient use of the transmission system. This is

because cost-reflective charges appropriately signal the costs of locating at different points of the transmission system.

Ofgem recognises that in isolation, some elements of the proposed modification, such as charging for generation only spurs via use of system charges, may lead to a lesser degree of cost reflection. Ofgem believes, based on the analysis provided by NGC via the consultation process, that overall cost-reflection in charges will be ensured via the proposed changes to NGC's Use of System Methodology via UoSCM-M-10. In particular, the zoning criteria applied to the use of system charges, will ensure that particularly expensive nodes, for example those with costly generation only spur lines, are grouped into separate zones to ensure that use of system charges reflect locational costs of providing the transmission system at different points of the system. Therefore, Ofgem considers that the combined effect of CCM-M-07 and UoSCM-M-10 will lead to better cost reflection in NGC's charges.

Ofgem believes that the changes to site specific maintenance charges will make these charges more cost-reflective and transparent, as these will be based on a pass through of actual costs rather than apportioning of overall maintenance costs based on historic factors. Ofgem notes that this may lead to more volatility year on year in site specific maintenance charges, but considers that this may be managed via the financial markets.

Ofgem also considers that CCM-M-07 would improve the transparency of connection charges. The current methodology could be seen as arbitrary in some cases, as a user's connection charge may be influenced by the actions of other users (especially at shared connection sites). Ofgem considers that the proposed modification removes this potential for arbitrariness in charge setting, enhancing both cost reflection and competition in generation.

Ofgem notes the concern of some users that the proposed modification would lead to a re-distribution of charges. Ofgem notes that currently generators contribute 27 per cent towards NGC's use of system charges. Ofgem also notes that when considering use of system and connection charges together, generators contribute approximately 25 per cent. Ofgem notes NGC's intention to review the current 27/73 split between generators' and suppliers' share of use of system charges, to ensure that the overall 25/75 split is maintained. Ofgem therefore does not consider that the proposed modification would introduce any cross-subsidy between generation and demand.

Ofgem also notes the concern of some respondents that DNOs will not pass on the savings in NGC connection charges to customers. Ofgem considers that the DNO price controls are structured in such a way that DNO's must pass through directly to customers all NGC connection charges. This means that any change in NGC's connection charges paid by DNOs should automatically feed through to customers. Ofgem recognises that the exact methodology for how any adjustments are passed on to customers may vary between DNOs. Ofgem considers that DNOs and customers should work together to ensure an equitable pass-through of any reductions in NGC connection charges that DNOs pay. Customers can ultimately apply to Ofgem for a determination if they cannot agree the level of charges with their DNO.

Ofgem does not agree with those respondents that consider the proposed modification would increase the likelihood of uneconomic connections being provided as the changes to the Use of System Charging Methodology via UoSCM-M-10 will ensure cost reflection in NGC's charges. In addition, Ofgem agrees with NGC that there are a number of obligations placed on NGC to ensure economic and efficient investment in its transmission system. Ofgem considers that NGC should take these obligations into account when developing its system.

For the reasons set out in this section, Ofgem believes that the proposed modification will lead to better cost reflection in NGC's charges.

The Relevant Objective of facilitating effective competition in the generation and supply of electricity and in the sale, distribution and purchase of electricity.

As highlighted above, Ofgem considers that CCM-M-07 will better facilitate NGC's obligation to provide non-discriminatory access to its transmission system. Ofgem considers that by ensuring generators can access the transmission network on a non-discriminatory basis, barriers to entry in the generation market will be removed. Ofgem also considers that CCM-M-07 will ensure cost reflection in NGC's charges. Improved cost reflection removes cross-subsidies in charges, and encourages more efficient use of the transmission system. Ofgem believes that this enables generators to reflect savings of locational decisions in the pricing of their products to customers, to the benefit of competition.

Ofgem agrees with those respondents that considered that CCM-M-07 will remove risks associated with sharing assets. Currently, the charge of a user at a shared site may change significantly if another user for example requires an upgrade to the connection or disconnects and leaves the site. Ofgem considers that CCM-M-07 will remove the potential for volatility in charges to users as all shareable assets will be charged via use of system charges. Again, this should promote competition.

The Relevant Objective of facilitating competition in the carrying out of works for connection to NGC's transmission system.

Ofgem considers that charging for shareable assets via use of system charges will make it easier for users to undertake maintenance on contestable connection assets. Ofgem also considers this may provide more scope for competition in carrying out connection works on the remaining connection assets. Ofgem therefore considers that CCM-M-07 will better facilitate the Relevant Objective of facilitating competition in the carrying out of works for connection to NGC's transmission system.

The Relevant Objective that, the connection charging methodology properly takes account of the developments in NGC's transmission business.

As all shareable assets will be charged for via use of system charges, Ofgem considers that removing the associated land charges and type B termination charges (relating to shared assets) from the connection charging methodology would ensure that NGC properly takes account of

developments in its business. Ofgem notes that NGC has proposed consequential changes to the CUSC to address the changes to land charges and site specific maintenance charges.

Other considerations

Ofgem considers that where assets are shared, such as at shared connection sites, the roles of responsibility for particular assets may be blurred to the extent that it may impact on the wider transmission system. Ofgem considers that CCM-M-07 removes any potential for blurred responsibilities, as all shareable assets will become part of infrastructure, and be the responsibility of NGC.

Ofgem believes that the proposed changes to NGC's Charging Methodologies will not lead to a change in the amount of revenue that NGC collects from its users. This is because any drop in connection income should be reflected in an increase in use of system income. To ensure that NGC can increase its use of system charges to recover the drop in connection charges. Ofgem has concurrently approved a change to NGC's transmission licence.

Ofgem notes respondents' concern that no clear principles have been established by NGC for addressing repayments to users for legacy issues. Ofgem agrees that these issues need to be addressed urgently, and in as a transparent way as possible recognising the commercially sensitive nature of these issues. Ofgem considers that NGC and users should resolve this on a bilateral basis as soon as is possible. Obviously, if NGC and Users are unable to resolve any bi-lateral issues then it is open to either Party to refer the issue to Ofgem for ultimate determination (see transmission licence condition C7E.3).

Finally, Ofgem notes the concern raised by one respondent that changes to the Charging Methodologies should be supported by a full regulatory impact assessment and that the change process should be made more inclusive. Ofgem considers that it is the role of NGC, in consultation with interested parties, to assess proposals for changing the Charging Methodologies. Ofgem's role is to assess the proposed modifications in light of its wider statutory duties, the Relevant Objectives of the Charging Methodologies, and the evidence presented by NGC in the Conclusion Report. Ofgem considers this an inclusive and transparent process, ensuring that all views are represented when the Authority makes its decision.

Ofgem considers that the process leading up to the proposed changes to the charging methodologies has been open and accessible, inviting views from interested parties from an early point in the process. Ofgem believes that parties that have specific concerns with the Charging Methodologies may raise these with NGC, or bring them to the attention of Ofgem if necessary. Ofgem's 9 June 2003 open letter on NGC's charging review provided a specific opportunity to provide comments to Ofgem, and Ofgem has had regard to all views received when making its decision not to direct that the proposed modification may not be made.

BETTA and GB wide consultation

Ofgem notes that some respondents considered the proposed modification would lead to an abrupt change in charges, and therefore should not be made. Other respondents considered that the changes should not be made until BETTA has been implemented. However, Ofgem considers that NGC must continue to discharge its obligations under the transmission licence, including proposing modifications to change the Charging Methodologies that better facilitate the Relevant Objectives of these methodologies. Ofgem's principal objective is to protect consumers, wherever possible via promoting competition. It would not be consistent with this objective and Ofgem's wider statutory duties to veto any proposals that are beneficial to consumers. Both Ofgem and NGC must continue to discharge their respective statutory duties and licence objectives regardless of the progress on implementing BETTA. As Ofgem considers the proposed modification will better facilitate the Relevant Objectives of the Charging Methodologies, and protect consumers, it would not be appropriate for Ofgem to veto these proposals.

On 17 January 2003, Ofgem wrote to the chairmen of the Balancing and Settlement Code Panel and the Connection and Use of System Code Amendments Panel to explain that Ofgem would consider whether to consult on modifications on a GB wide basis from the time of second reading in Parliament of the Bill necessary to introduce BETTA. Ofgem wrote to the chairmen again on 5 December, giving further guidance on the process for consultation leading up to BETTA[14]. The draft Energy Bill, which will enable introduction of BETTA, had its second reading in Parliament on 11 December 2003[15].

Ofgem will consider, on a case by case basis, whether proposals to modify NGC's Charging Methodologies merit GB wide consultation prior to Ofgem making its decision. Wherever possible, Ofgem intends to conduct the GB wide consultations in parallel with NGC's consultation, to allow Ofgem to have view of any GB representations when making its decision on these modification proposals.

Ofgem has decided not to consult GB wide on CCM-07 and UoSCM-10. NGC is conducting a GB wide consultation on GB Charging Methodologies, which includes the proposed changes in CCM-M-07 and UoSCM-M-10[16]. Ofgem will have regard to all responses to NGC's consultation when making its decision on GB wide charging methodologies.

[14] These letters can be downloaded from Ofgem's webpage on www.ofgem.gov.uk
[15] See Hansard available from http://www.parliament.the-stationery-office.co.uk/pa/ld199697/ldhansrd/pdvn/lds03/text/31211-01.htm#31211-01_head0
[16] NGC's consultation document was issued 16 December and is entitled "GB Transmission Charging: Initial Thoughts". It is available from NGC's website at http://www.nationalgrid.com/uk/indinfo/charging/pdfs/NG_GB_Charging_Initial_Thoughts.pdf. NGC has invited responses by 30 January 2004.

The Authority's Decision

The Authority has therefore decided **not to direct** that the proposed CCM-M-07 may not be made.

Please contact me on the above number if you have any queries in relation to the issues raised in this letter.

Yours sincerely

Sonia Brown
Director, Electricity Trading Arrangements
Signed on behalf of the Authority and authorised for that purpose by the Authority