



Direct Dial: 020-7901-7008

23 April 2004

The National Grid Company, CUSC Signatories and
Other Interested Parties

Our Ref: UoSCM-M-12

Dear Colleague

**Decision in relation to Use of System Charging Methodology Modification UoSCM-M-12:
Proposed change to the TNUoS demand monthly charges rules.**

The Gas and Electricity Markets Authority (the Authority)¹ has carefully considered the issues raised in the conclusions report² in respect of the proposed Use of System Charging Methodology Modification¹² (UoSCM-M-12) 'proposed change to the TNUoS demand monthly charges rules'.

The National Grid Company plc (NGC) submitted the conclusions report to the Authority on 26 March 2004 and recommended to the Authority that the Statement of the Use of System Charging Methodology be amended as of 1 May 2004, to include the methodology for the determination of a National Grid demand forecast and a number of worked examples.

Ofgem approves of the proposed UoSCM-M-12 and therefore will not direct that the modification may not be made]. The modification will therefore be implemented on 1 May 2004 as set out in the conclusions report.

This letter sets out the background to the modification proposal, explains the proposed modification and its interaction with Connection and Use of System Code (CUSC) Amendment

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

² Conclusions Report, Modification Proposal to the Use of System Charging Methodology, UoSCM-M-12. Proposed change to the TNUoS demand monthly charges rules, dated 26 March 2004. The Conclusions Report is available at http://www.nationalgrid.com/uk/indinfo/charging/pdfs/UoSCM-M-12_Conclusions_Report_v1.0.pdf

Proposal 055 (CAP055), summarises respondents' views and sets out Ofgem's reasons for its decision.

Background

NGC considers that the current arrangements within the CUSC do not place sufficient incentive on parties to provide accurate demand forecasts for the purpose of calculating Transmission Network Use of System (TNUoS) charges. Whilst paragraph 3.10.1 within section 3 of the CUSC places a requirement upon users to submit forecasts to NGC, it is not prescriptive in terms of the quality of data required for forecasting purposes.

The proposer considers that the absence of sufficiently robust rules concerning the quality of forecast data can potentially result in reconciliation becoming the primary means for levying demand charges to some users, thereby undermining the principle of monthly invoicing at a level reflective of system usage. NGC considers that this could create issues such as:

- inequality between suppliers being created where TNUoS demand charges are based on forecasts which vary in their degree of accuracy;
- asymmetric competition between suppliers; and
- increasing NGC exposure to supplier failure.

In order to address the issue, NGC identified that changes to both the CUSC and use of system charging methodology would be required.

Amendment proposal CAP055 was raised by NGC on 18 September 2003, was submitted for consideration by the CUSC Amendments Panel (the Panel) on 26 September 2003 and was then evaluated by a working group. Following the final report³ CAP055 proceeded to wider consultation⁴ in parallel with the timescales for UoSCM-M-12.

CAP055 proposes to allow NGC to reject any forecasts that it considers to be unreasonable and, where necessary, to replace these forecasts with NGC's own reasonable estimates. The Proposer also considered it would result in greater protection for the industry as a whole in addressing the non-payment of TNUoS charges arising from failing Suppliers. The Working Group proposed that a divergence of 20% between a User's demand forecast and NGC's own demand forecast

³ The amendment report in respect of CAP055 can be found at <http://www.nationalgrid.com/uk/indinfo/cusc/admin/scripts/uploads/CAP055%20-%20Final%20Amendment%20Report%20Version%201.0.pdf>

⁴ The consultation document in regard to CAP055 is available at <http://www.nationalgrid.com/uk/indinfo/cusc/admin/scripts/uploads/CAP055%20Consultation%20Document%20Version%201.pdf>

would constitute an acceptable level of inaccuracy without including normal but unpredictable fluctuations in a user's demand.

The working group decided that the formula used for calculating NGC's demand forecast should be contained within the statement of the use of system charging methodology and NGC consequently raised UoSCM-M-12 on 28 November 2003⁵, with responses invited by 4 January 2004. Ofgem decided to conduct a GB wide consultation on CAP055 and, in order to ensure that the two proposals could be assessed simultaneously; NGC deferred submitting the conclusions report on UoSCM-M-12 to the Authority until 26 March 2004.

NGC considers that UoSCM-M-12 better facilitates achievement of all three of the relevant objectives⁶ of the use of system charging methodology. It considers that the modification would do this by ensuring:

- consistent treatment between Users incurring TNUoS demand charges;
- TNUoS charges are reflective of system usage and levied near to the time of occurrence;
- the charging methodology is transparent and incentivises Users to submit accurate demand forecasts for the purpose of calculating TNUoS demand charges; and
- the charging methodologies reflect developments within NGC's transmission business.

NGC also considers that the modification would ensure that the charges it levies do not discriminate between any persons or classes of persons as required under Condition C7C of the transmission licence, by ensuring consistent treatment of users incurring charges based on their own forecasts of demand.

⁵ The consultation document in regard to UoSCM-M-12 is available at http://www.nationalgrid.com/uk/indinfo/charging/pdfs/UoSCM-M-12_Demand_Forecasts_for_TNUoS_Charging.pdf

⁶ 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.

The Proposed Modification

The proposed modification UoSCM-M-12 seeks to include a methodology for the determination of a NGC demand forecast in chapter 4 (Demand Charges) of the statement of the use of system charging methodology. The proposed text is contained within Appendix 2 of the conclusions report. The proposal also inserts a number of worked examples into appendix TN-7 and updates Chapter 6 (Data Requirements) to ensure consistency with the revisions to chapter 4.

Demand charges will continue to be calculated using a user's forecast of their demand, where this forecast is deemed reasonable in accordance with the CUSC. Should a forecast be deemed unreasonable, a NGC demand forecast, calculated in accordance with the formula set out in the statement of the use of system charging methodology, will be used for charging purposes, unless the user is able to provide evidence to verify the validity of the original forecast.

Respondents' views

NGC issued a consultation paper on 28 November 2003 inviting responses from CUSC parties and interested parties by 4 January 2004.

NGC received four responses to the consultation, of which three supported the modification, although two qualified their support, and one provided comments without expressing support or opposition to the proposal.

One respondent agreed with the proposal in principle but questioned an element of its drafting, stating that the wording was inconsistent with what had been agreed by the working group. The respondent stated that it had been agreed that only the total TNUoS charge liability calculated from a user's demand forecast would be assessed against NGC's total calculated charges for that user and requested that the proposal be amended to remove references to criteria applying on a Balancing Mechanism Unit (BMU) basis.

One respondent expressed support for the modification, stating that it provides the necessary transparency of the NGC demand forecasting methodology. The respondent considered that this will ensure that the process for validation of users' demand forecasts is equitable and that monthly charging invoices are cost-reflective.

The other respondent in favour of the modification considered that the changes will better meet the relevant licence objectives but questioned whether the CUSC would be a more appropriate location for the methodology used to calculate NGC's forecast. The respondent agreed that a potential defect exists and considered that this potentially creates cash-flow advantages to some users and is likely to increase the exposure of NGC, and other parties, to supplier failure. The respondent considered that ensuring that users incurring TNUoS demand charges are treated consistently should facilitate effective competition and ensure a greater level of cost-reflectivity.

The respondent stressed that the proposal would only achieve the desired effect if it was seen as equitable and transparent and stated that dialogue between NGC and a user would be essential in the event that a forecast were deemed unreasonable. The respondent stated that the suggested level of 20% accuracy seems appropriate, provided that variations outside of this limit are dealt with fairly and with common sense.

The final respondent raised a number of questions concerning the proposal without expressing support or opposition. The respondent requested further information concerning the magnitude of the defect being addressed and asked for details of the level of over forecasting, which it considered could offset, or partially offset, any under forecasting. The respondent also suggested that, in the event of disputes over the use of an NGC forecast, determinations should be referred by the user to the Authority. They requested that details should also be provided to the CUSC panel on the number of times a forecast has been replaced and the frequency and success rate of appeals against this. The respondent additionally questioned whether a cost/ benefit analysis had been undertaken to support the statement that the overall level of demand TNUoS charges will be unchanged, stating that it had not been demonstrated that the proposal would provide benefits which outweigh the costs of calculating NGC forecasts and conducting the consultation exercise.

The respondents' views are summarised and contained in the conclusion report in respect of UoSCM-M-12.

NGC's view

NGC addressed the respondent's concern that the conclusions report was not reflective of working group discussions and one change was made to the final proposal. This change clarified that the charging methodology wording should refer to a user's forecast of total demand, rather than a Balancing Mechanism Unit basis, and the proposed wording of Paragraph 4.12 of the statement of the use of system charging methodology was revised to reflect this.

NGC recommended to the Authority that the proposed methodology for calculating NGC's demand forecast and a number of worked examples, as detailed in the UoSCM-M-12 conclusions report, should be inserted into chapter 4 and appendix TN-7 of the statement of the use of system charging methodology.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that the implementation of UoSCM-M-12 would better achieve the relevant objectives of the use of system charging methodology, as set out below.

Relevant objective 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.

Ofgem considers that including a transparent methodology for the calculation of NGC's demand forecast within the statement of the use of system charging methodology will ensure consistent treatment between all users incurring demand TNUoS charges. Any disincentive to submit artificially low forecasts or not to submit a forecast will be minimised, removing present inequalities and limiting the opportunity for such inequalities to occur in future.

The proposal will mean that reconciliation will no longer be used as the major vehicle for levying TNUoS charges. Ofgem considers that the proposal will lead to a greater proportion of TNUoS charges being levied close to the time of occurrence and being increasingly reflective of actual system usage. Ofgem considers that this will mitigate NGC, and users', exposure to potential supplier failure, reducing risk and creating a more stable market place.

By ensuring the consistent treatment of users incurring charges where such charges are based upon the users' own demand forecast, Ofgem considers that the modification would also ensure that NGC charges do not discriminate between any users or classes of user.

Relevant objective 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.

Ofgem considers that incorporating a transparent methodology for the calculation of NGC's demand forecast into the use of system charging methodology will incentivise users to provide accurate demand forecasts. Ofgem considers that this will improve the accuracy of TNUoS charges.

As a higher percentage of TNUoS charges will be payable following monthly invoicing, rather than at the reconciliation stage, Ofgem considers that NGC, and market participants, will be less exposed to non payment in the event of supplier failure, lessening the chances of parties defaulting on payments and hence reducing the chances of NGC being unable to fully recover its costs.

Relevant objective 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.

Ofgem considers that the modification to the use of system charging methodology will mean that it is consistent with the CUSC, as amended by CAP055, and hence properly takes account of developments in the licensee's transmission business.

The Authority's Decision

The Authority approves of the proposed UoS_{CM}-M-12 and therefore will not direct that the modification may not be made. The proposed UoS_{CM}-M-12 will therefore be implemented on 1 May 2004, as set out in the conclusion report to the Authority.

The Authority considers that the revisions to the statement of the use of system charging methodology detailed in the conclusions report in regard to the proposed amendment reflect the intentions of the modification proposal. Ofgem considers that NGC should revise the statement of the use of system charging methodology as of 1 May 2004 in order to comply with condition C7(8) of its transmission licence.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'A Walker'.

Andrew Walker
Director, Transmission

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