



Direct Dial: 020-7901-7412

16 January 2003

The National Grid Company, CUSC Signatories and
Other Interested Parties

Our Ref: CCM-M-04

Dear Colleague

Decision in relation to Connection Charging Methodology Modification-04: 'Implementation of changes required for CAP012 'Procedure for renewal of NGC (connection) assets''

The Gas and Electricity Markets Authority (the 'Authority')¹ has carefully considered the issues raised in the Conclusions Report² in respect of the proposed Connection Charging Methodology Modification-04 ('CCM-M-04') 'Implementation of changes required for CAP012 'Procedure for renewal of NGC (connection) assets''.

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 CCM-M-04 should be implemented.

Ofgem has decided not to veto the proposed CCM-M-04. The modification will therefore be implemented on 01 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.

Background

Default charge on assets operating beyond their replacement period

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 agreement on charging with the User.

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 Connection Charging Methodology, CCM-M-04. 'Implementation of changes required for CAP012 'Procedure for renewal of NGC (connection) assets'', dated 19 December 2002.

As part of Ofgem's approval of NGC's Connection Charging Methodology³ ('June 2001 document'), the Authority imposed the following condition on NGC:

'NGC shall review its charging methodology regarding assets operating beyond their replacement period, provide a report to Ofgem of the results of its review, with reasons in reasonable detail of its conclusions, and if appropriate, initiate the procedure for changing its methodology so that any such change could take effect from 1 April 2002.'

NGC initiated a review of its charging methodology regarding assets operating beyond their replacement period by publishing a review paper on 8 August 2001. Following this review, NGC proposed Connection Charging Methodology Modification-03 'Implementation of Review Conclusions for Assets Operating Beyond Their Replacement Period' ('CCM-M-03') on 20 November 2001. CCM-M-03 proposed an interim solution for 2002/03. The interim solution removed the default 2.5% of Gross Asset Value charge on assets that operate beyond the end of their lifetime for those Users who agreed to vary their bilateral agreement with NGC. The agreement to vary extended the replacement period for those assets that were beyond their lifetime to age plus one year. NGC issued the conclusions report for CCM-M-03 on 21 December 2001.

Ofgem decided not to veto CCM-M-03 and it was therefore implemented on 1 April 2002. Ofgem's reasons for its decision not to veto CCM-M-03 were set out in its decision letter of 17 January 2002. Ofgem stated that the removal of the default 2.5% charge on assets operating beyond the end of their lifetime would produce more cost reflective charges and enhance competition in generation and supply of electricity.

Following the CCM-M-03 process, NGC initiated discussions with its Users to develop an enduring solution to agree the framework for replacing assets and the charges for assets that operate beyond the end of their lifetime. Discussions were held in the Transmission Charging Methodology Forum and in workshops with Users. From this process, three scenarios were identified:

- ◆ **Scenario 1 – Works required:** This scenario identified the process between NGC and the User(s) to agree on works on assets that need replacing. Any assets that are operating beyond the end of their replacement period would not be charged the 2.5% default charge, but would be charged maintenance and transmission running costs. Charges for new assets would be calculated in the normal way from an agreed charging date. There would also be a mechanism to refer disputes to Ofgem.
- ◆ **Scenario 2 – Status Quo:** Under this scenario, no need for work on assets has been identified. The ongoing charge beyond the replacement period would only consist of maintenance and transmission running costs. The default 2.5% charge would be removed. This scenario linked back into scenario 1 so that if the asset condition should deteriorate and replacement becomes necessary, there is a mechanism for NGC and the User(s) to agree on the replacement of the assets.

³ "The National Grid Company: Approval of the Use of System and Connection Charging Methodologies. Decision Document", Ofgem, June 2001.

- ◆ **Scenario 3 – Finite life extension:** Users that know they will be exiting a site after a defined, finite, period may apply to NGC for a finite period life extension of their assets. Following an assessment of assets' conditions, NGC may make a finite period life extension offer to the User. The offer would detail all charges, reflecting the risk that NGC is taking of assets having to be replaced during the finite period.

Asset Renewal

In parallel, issues relating to asset renewal were being addressed in the Connection and Use of System Code ('CUSC') by Amendment Proposal CAP012 'Asset Renewal'. Innogy raised Amendment Proposal CAP012 on 3 January 2002. Amendment Proposal CAP012 sought to introduce more transparency in the process of asset renewal, including a requirement on NGC to provide engineering and economic reasons to a User whose assets it wants to replace. The Amendment Proposal also sought to remove the distinction in treatment between connection assets pre and post the Replacement Period. Finally, the Amendment Proposal also provided Users with recourse to an independent engineer to resolve any dispute with NGC in regard to replacement of connection assets.

NGC raised Alternative Amendment A during the consultation on Amendment Proposal CAP012. Alternative Amendment A was based on the Amendment Proposal but did not provide Users with recourse to an independent engineer. The Authority approved Alternative Amendment A on 2 September 2002⁴.

Approved Alternative Amendment A is to take effect from 1 April 2003. The process that will be implemented with the Approved Amendment removes the need for the default charge on connection assets that operate beyond their Replacement Period.

CCM-M-04

NGC published a consultation document for CCM-M-04 on 11 November 2002. NGC considered that proposed modification CCM-M-04 would better facilitate achievement of the Relevant Objective of properly taking account of developments in its transmission business⁵.

⁴ The Authority's decision letter containing the reasons for its decision can be found on NGC's website: <http://www.nationalgrid.com/uk/indinfo/cusc/>

⁵ The Relevant Objectives of the Connection Charging Methodology, as contained in Condition C7B.11 of National Grid Company's 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.

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 CCM-M-04 seeks to modify the Connection Charging Methodology to reflect the new process for asset renewal being put in place in the CUSC by Approved Amendment CAP012.

As noted above, the process that will be implemented with the Approved Amendment CAP012 removes the need to for default charge on connection assets that operate beyond their Replacement Period. CCM-M-04 therefore seeks to remove this charge from the Connection Charging Methodology.

Respondents' views

NGC issued a consultation paper on 11 November 2002 inviting responses from CUSC Parties and interested parties by 9 December 2002.

NGC received eight responses to the consultation, of which seven supported the modification and one respondent had no comments regarding the proposed modification.

One of the respondents in support of the modification expressed concern over the proposed definition of 'Depreciation Period' and proposed to extend the definition by adding one sentence: *'Unless otherwise specified this will be 40 years'*.

The respondents' views are contained in the Conclusion Report in respect of CCM-M-04.

NGC's view

In light of the responses received, NGC decided to change the definition of 'Depreciation Period' in the proposed modification. NGC added one sentence to the definition: *'Unless otherwise specified this will be 40 years'*.

NGC recommended to the Authority that CCM-M-04 should be made and implemented on 1 April 2003.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that CCM-M-04 would better facilitate achievement of the Relevant Connection Charging Methodology Objectives.

Ofgem considers that CCM-M-04 would ensure that the Connection Charging Methodology continues to be consistent with the CUSC following implementation of Approved Amendment CAP012. Ofgem considers that this facilitates achievement of the Relevant Objective of properly taking account of the developments in the licensee's transmission business.

Ofgem also considers that the removal of the default charge for assets operating beyond the replacement period will produce more cost reflective charges as the depreciation costs of these

assets would already have been paid for. Ofgem also considers that this will also facilitate effective competition in generation and supply.

As noted in the June 2001 document, Ofgem believes that NGC's ability to manage a safe and secure transmission network is paramount, particularly where ageing assets are involved. Ofgem expects NGC to be satisfied that an asset will meet its operational and safety requirements before any arrangements for the extension of its life are considered.

Ofgem notes the discussions that have taken place with the industry prior to raising this modification and notes the difficulties surrounding scenario 3 and NGC's intention not to develop this further. Ofgem considers that scenario 3 should not be rejected outright. It is possible that future developments in NGC connection charging may resolve some of the difficulties encountered with regards to developing scenario 3. Therefore, NGC and Users may wish to revisit scenario 3 in future.

The Authority's Decision

The Authority has therefore decided not to veto the proposed CCM-M-04. The modification will therefore be implemented on 01 April 2003 as set out in the Conclusions 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'.

Sonia Brown

Director, Electricity Trading Arrangements

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