



National Grid

CONSULTATION DOCUMENT

**Modification Proposal to the
Connection Charging Methodology**

CCM-M-03

**Implementation of Review Conclusions for Assets
Operating Beyond Their Replacement Period**

20 November 2001

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1. Executive Summary

This paper sets out for consultation National Grid's proposed modification to the Connection Charging Methodology to take account of the short term process for assets operating beyond their Replacement Period as concluded in the Methodology Review (CCM-R-01) in October. This and the associated Ofgem conclusion on the review paper are published on the National Grid web-site at the following address:

www.nationalgridinfo.co.uk/charging/mn_tcmf.html

2. Introduction

National Grid is obliged under the Transmission Licence:

- (i) to make revisions to the Charging Statements in order that the information set out in these statements shall continue to be accurate in all material respects;
- (ii) to keep the Connection Charging Methodology at all times under review;
- (iii) to make such modifications of the Connection Charging Methodology as may be requisite for the purpose of better achieving the relevant objectives, which are:
 - a. to facilitate 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;
 - b. to result in charges which reflect, as far as reasonably practicable, the costs incurred by National Grid in its Transmission Business; and
 - c. to take account of the developments in National Grid's Transmission Business.
 - d. to facilitate competition in the carrying out of works for connection to National Grid's Transmission system.

Before making a modification to the Connection Charging Methodology, National Grid is also required by the Transmission Licence to consult with CUSC Users on the proposed modification and allow them a period of not less than 28 days within which to make written representations. The Authority can consent to a shorter consultation period.

The purpose of this document is to set out for consultation National Grid's proposal to modify the Statement of the Connection Charging Methodology to meet the Relevant Objectives in LCC7B 11(a) and 11(b) of facilitating competition in generation and supply and ensuring National Grid reflects the costs incurred by its Transmission Business.

3. Background to the Issues

As part of the conditions imposed by Ofgem on their approval of the Connection Charging Methodology, National Grid agreed to carry out a consultation and review its charging methodology for assets operating beyond their Replacement Period. The conclusion of the review was to implement a short term process to cover assets that are already or will become 40 years old or over in the next charging year and also in the longer term to agree enduring arrangements for assets operating beyond their Replacement Period. Ofgem accepted the conclusion of the review.

The intention is for this short term process to become effective from 1 April 2002. In order to implement this, the Connection Charging Methodology needs to be changed to take account of this short term process for assets operating beyond their Replacement Period and the Statement of the Connection Charging Methodology updated accordingly.

This modification paper proposes the necessary change to the Connection Charging Methodology (see Appendix 1) and the required changes to Chapter 7 of the Statement of the Connection Charging Methodology (see Appendix 3).

National Grid is currently reviewing the enduring arrangements. This is in consultation with Users and any conclusions, which require a change to the Connection Charging Methodology and the Statement of the Connection Charging Methodology will be carried out through a separate modification process.

4. Explanation of the Issues

The change to the Connection Charging Methodology is required is to take into account the proposed short term process. An Agreement to Vary all the Bilateral Agreements for assets at the Users sites which are or will be over 40 years old in the next charging year has been offered. For example, for the next financial year, this will make the Replacement Period for all assets on Appendix A Part 1, Part 2 and non-electronic components in Part 3, the greater of either forty years or Charging Age as of 1 April 2002 plus one year.

Upon acceptance of this Agreement to Vary, the charges from April 2002 for assets aged over 40 years will solely cover ongoing site specific maintenance and transmission running costs, i.e. there will be no default 2.5% of GAV charge applied to these assets.

Subject to replacement of the asset(s) prior to the end of the revised Replacement Period or the need to issue a replacement notice, this process will be repeated annually as appropriate pending agreement as to enduring arrangements. If NGC serves a notice to asset replace before the end of the revised Replacement Period and the asset(s) is replaced within the Replacement Period, then the User(s) will begin payment for the replacement asset(s) at the end of the Replacement Period.

5. Proposed Modifications

Proposed Changes to the Connection Charging Methodology

It is proposed that the Connection Charging Methodology is modified as indicated in the Outline of the Proposed Modification, Appendix 1.

Proposed Changes to the Statement of the Connection Charging Methodology

It is proposed that Chapter 7 of the Statement of the Connection Charging Methodology is modified as indicated Appendix 3. For information, the original wording from Chapter 7 is provided in Appendix 2.

Indicative Impact on Connection Charges

The indicative impact on charges will be that Users with assets that are operating beyond their current Replacement Period and who agree to sign the offer of this Agreement to Vary the Bilateral Agreement for the following charging year, will only pay charges for ongoing site specific maintenance and transmission running cost charges for assets with a chargeable age of greater than 40 years. They will not be charged 2.5% of GAV in their connection charge for those assets.

Impacts on Other Industry Documents

There is no impact on other industry documents.

6. Responses to this Consultation

Comments and views are invited on all the issues raised in this consultation document. In order that your comments and views are considered as part of National Grid's report to the Authority, responses must be received by **18 December 2001**. If you wish to provide comments on this proposed modification, then responses are welcome via e-mail to:

Sarah.McGill@uk.ngrid.com

Or alternatively, written comments may be addressed to:

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If you have further queries, please do not hesitate to contact Sarah McGill on: **02476 423841**.

Appendix 1- Outline of Proposed Modification

Description of proposed modification

To modify the Connection Charging Methodology and update Chapter 7 of the Statement of the Connection Charging Methodology in line with the conclusions from the Methodology Review (CCM-R-01) which were accepted by Ofgem on 25th October 2001. This paper and Ofgem's conclusions are available on the National Grid web-site at the following address:

www.nationalgridinfo.co.uk/charging/mn_tcmf.html

Explanation of the issue

As part of the conditions imposed by Ofgem on their approval of the Connection Charging Methodology, National Grid agreed to carry out a consultation and review its charging methodology for assets operating beyond their Replacement Period. The conclusion of the review was to implement a short term process to cover assets that are already or will become 40 years old in the next charging year and also in the longer term, to agree enduring arrangements for assets operating beyond their Replacement Period. Ofgem accepted the conclusion of the review.

The short term process, outlined below, is proposed to become effective from 1 April 2002.

- Until agreement on enduring arrangements is reached with a User(s) about assets that are operating beyond their Replacement Period, then the short term process is to offer an Agreement to Vary all the Bilateral Agreements for the assets at User's sites which are or will be in the next charging year operating beyond their Replacement Period.
- The Agreement to Vary recently set out, if signed, will become effective from 1 April 2002, and will make the Replacement Period for all assets on Appendix A Part 1, Part 2 and non-electronic components in Part 3, the greater of forty years or Charging Age as of 1 April 2002 plus one year.
- Upon acceptance of this Agreement to Vary, the charges from the following April for assets aged over 40 years will solely cover ongoing site specific maintenance and transmission running costs, i.e. there will be no default 2.5% of GAV charge applied for these assets.
- Subject to replacement of the asset prior to the end of the revised Replacement Period or the need to issue a replacement notice, this process will be repeated annually as appropriate pending agreement as to enduring arrangements.

<p>Justification for proposed modification</p> <p>To better meet the Relevant Objectives in LCC7B 11(a) and 11(b) of facilitating competition in generation and supply and ensuring National Grid reflects the costs incurred by its Transmission Business.</p>
<p>Suggested alternatives</p> <p>None</p>
<p>Implementation date</p> <p>1 April 2002</p>
<p>Proposed changes to the Statement of the Connection Charging Methodology</p> <p>Appendix 2 sets out the existing wording on Assets Operating after their Replacement Period in Chapter 7 of the Statement of the Connection Charging Methodology for reference.</p> <p>Appendix 3 sets out the proposed new wording for Chapter 7 of the Statement of the Connection Charging Methodology in line with the modification proposal.</p>
<p>Impacts on existing Connection charges</p> <p>Users with assets that are operating beyond their current Replacement Period and who agree to sign the offer of this Agreement to Vary the Bilateral Agreement for the following charging year, will only pay charges for ongoing site specific maintenance and transmission running cost charges for assets with a chargeable age of greater than 40 years. They will not be charged 2.5% of GAV in their connection charge for those assets.</p>
<p>Impacts on other Industry Documents</p> <p>None.</p>

Appendix 2 - Existing Wording on Assets Operating Beyond Their Replacement Period

Chapter 7: Asset Replacement

Early Asset Replacement

- 7.1 Appendix A of a User's Bilateral Connection Agreement specifies the age, for charging purposes, of each of the NGC assets at the Connection Site for the corresponding Financial Year. Connection charges are calculated on the assumption that the assets will not require to be replaced until the expiry of their Replacement Period. If in NGC's reasonable opinion, an asset requires replacement before the expiry of its Replacement Period, NGC will continue to charge for the original asset and make no charges to the existing Users for the new asset until the expiry of the original Replacement Period.
- 7.2 At the expiry of the original Replacement Period the User's charge will be calculated on the then Net Asset Value of the new asset, i.e. the new asset begins depreciation, for charging purposes, on commissioning.

Assets Operating after their Replacement Period

- 7.3 If assets have remained in service beyond their Replacement Period in line with a counter notice issued by the User under CUSC, NGC will seek to agree with the User an appropriate level of connection charges for those assets. In this situation, if, on the expiry of the Replacement Period, NGC and the User have failed to agree on a level of charges, the charges will be set at a level equal to the charge in the last Financial Year of the original Replacement Period (the 'deemed charge') and the matter may be referred to the Authority for determination.
- 7.4 If NGC have notified that assets will remain in service beyond their Replacement Period (i.e. not notified an intention to replace the asset on the expiry of the Replacement Period) and no counter notice has been served by the Users, in the absence of any other agreement with the User, connection charges for the asset in year 'n' will be calculated as follows:

$$\text{Annual Charge}_n = \text{GAV}_n * 2.5\% + \text{SSF}_n (\text{RPIGAV}_n) + \text{TC}_n (\text{GAV}_n)$$

- 7.5 The GAV will be re-valued in line with the applicable valuation method (RPI or MEA). The 2.5% factor reflects the risk NGC is taking, in the absence of any other agreed charges going forward if assets operating beyond their replacement period require replacement. Ongoing site Specific Maintenance and Transmission costs are also included in the charge.
- 7.6 However, there are three main types of agreement, which may have been reached with the User.
- If NGC and the Users have agreed a date beyond the Replacement Period on which the asset(s) will be replaced and the User has accepted liability to pay charges for those new assets, then the 2.5% risk element will be

removed from the ongoing charges. Hence the charges will solely cover ongoing site specific maintenance and transmission cost charges.

- If NGC and the User have agreed that, once NGC serves a notice to asset replace, on commissioning the User will pay for the replaced assets, then again the 2.5% risk element will be removed from the ongoing charges. Again the charges will solely cover ongoing site specific maintenance and transmission cost charges.
- The User and NGC may agree a firm price agreement for a set period of time covering the assets which have remained in service beyond their Replacement Period which specifies that if the assets are replaced within this period, no changes to some elements of the charge are made. The level of charges again will reflect ongoing site specific maintenance charges and transmission cost charges but may also reflect an additional element reflecting the relative risks of replacement of the assets within the set period. This additional element may cover the risk of additional capital charges and/or termination liabilities.

In all the above agreements, charges will be changed from the following charging year after the date of the agreement. Hence they will not be retrospective.

It is the intention of NGC, in accordance with conditions imposed by Ofgem on the approval of this charging methodology, to carry out a review regarding assets operating beyond their replacement period. Having carried out a review, if appropriate, NGC will initiate the procedure for changing the methodology such that if changes are required, they will be planned to take effect from 1 April 2002.

Appendix 3 - Proposed New Wording on Assets Operating Beyond Their Replacement Period

Chapter 7: Asset Replacement

Early Asset Replacement

- 7.1 Appendix A of a User's Bilateral Connection Agreement specifies the age, for charging purposes, of each of the NGC assets at the Connection Site for the corresponding Financial Year. Connection charges are calculated on the assumption that the assets will not need to be replaced until the expiry of their Replacement Period. If in NGC's reasonable opinion, an asset requires replacement before the expiry of its Replacement Period, NGC will continue to charge for the original asset and make no charges to the existing Users for the new asset until the expiry of the original Replacement Period.
- 7.2 At the expiry of the original Replacement Period the User's charge will be calculated on the then Net Asset Value of the new asset, i.e. the new asset begins depreciation, for charging purposes, on the notified charging date.
- 7.3 If the replacement asset is not commissioned until after the Replacement Period, then the User's charges will solely cover ongoing site specific maintenance and transmission running cost charges and charges for the replacement asset will begin on the notified charging date of the replacement asset.

Assets Operating after their Replacement Period

- 7.3 Once assets have reached the end of their Replacement Period, there are a number of different types of agreement that may be reached between NGC and the User.
- 7.4 If NGC has notified that assets will remain in service beyond their Replacement Period (i.e. has issued revised Appendix A and B's showing the assets still in service) and no counter notice has been received from the User, the following alternative types of agreement are offered to Users:
- a. NGC and the User(s) agree a date beyond the Replacement Period on which the asset(s) will be replaced and the User(s) accepts liability to pay charges for those new assets upon commissioning. The charge for the original assets up to this date will then solely cover ongoing site specific maintenance and transmission running cost charges as stated in the equation below.

$$\text{Annual Charge}_n = \text{SSF}_n (\text{RPIGAV}_n) + \text{TC}_n (\text{GAV}_n)$$

- b. The User and NGC agree a firm price agreement for a set period of time covering the assets, which have remained in service beyond their Replacement Period. This agreement specifies that if the assets are replaced within this period, no changes to some elements of the charge are made. The level of charges again reflect ongoing site specific maintenance charges and transmission running cost charges, but may also reflect an additional element reflecting the relative risks of replacement of the assets within the set period. This additional element

may cover the risk of additional capital charges and/or termination liabilities.

- c. Pending agreement as to enduring arrangements as above, the user(s) agree to sign an offer of an Agreement to Vary the Bilateral Agreement for those assets currently or will be, within the next charging year operating beyond their Replacement Period. This will agree that the Replacement Period for all assets in Appendix A Part 1, Part 2 and non-electronic components in Part 3 will be the greater of 40 years or Charging Age at the start of the next financial year plus 1 year. Upon acceptance of this Agreement to Vary, the charges from the following April, for assets with a chargeable age of greater than 40 years, will solely cover ongoing site specific maintenance and transmission cost charges as shown in the equation above. If NGC serves a notice to asset replace before the end of the revised Replacement Period and the asset(s) is replaced within the Replacement Period, then the provisions in 7.1 to 7.3 apply.
- d. In the absence of agreement to any of the options covered in the three points (a), (b) & (c) above, connection charges for these assets in year 'n' will be calculated as follows:

$$\text{Annual Charge}_n = \text{GAV}_n * 2.5\% + \text{SSF}_n (\text{RPIGAV}_n) + \text{TC}_n (\text{GAV}_n)$$

The GAV will be re-valued in line with the applicable valuation method (RPI or MEA). Ongoing site Specific Maintenance and transmission running costs are included in the charge. The 2.5% factor reflects the risk to NGC, in the absence of any other agreement going forward of assets operating beyond their Replacement Period requiring replacement.

- 7.5 If NGC gives notice that an asset(s) is to be replaced and assets have remained in service beyond their Replacement Period in line with a counter notice is issued by the User under CUSC, then NGC will seek to agree with the User an appropriate level of connection charges for those assets. In this situation, if, on the expiry of the Replacement Period, NGC and the User(s) have failed to agree on a level of charges, the charges will be set at a level equal to the charge in the last Financial Year of the original Replacement Period (the 'deemed charge') and the matter may be referred to the Authority for determination.

National Grid is currently carrying out a review of the enduring arrangements which should apply for the options identified in paragraph 7.4. This involves discussions with Users and is expected to result in an enduring framework that is transparent and can be implemented as soon as possible. Once this review is complete, the intention would be to bring forward any necessary modifications to the Connection Charging Methodology to reflect the agreed arrangements.