

CONCLUSIONS REPORT

Modification Proposal to the Connection Charging Methodology

CCM-M-03

Implementation of Review Conclusions for Assets Operating Beyond the End of Their Replacement Period

21 December 2001

Introduction

1. Under Licence Condition C7 B of The National Grid Company plc's (National Grid) transmission licence, which came into effect on the implementation of the designated Connection and Use of System Code (CUSC), National Grid is required to determine and conform to a Connection Charging Methodology, approved by Ofgem.
2. National Grid must also prepare a statement of the Connection Charging Methodology to be approved by Ofgem. Ofgem consulted on the charging methodologies and approved the Connection Charging Methodology subject to a condition that National Grid:

“should review its Connection Charging Methodology regarding assets operating beyond their replacement period and provide a report to Ofgem of the results of its review, with reasons in reasonable detail for its conclusions. National Grid is then required, if appropriate, to initiate the procedure set out in the transmission licence for changing its methodology so that any such change could take effect from 1 April 2002.”

3. In order to meet this condition, National Grid have discussed the issue of assets operating beyond their Replacement Period at the industry-wide Transmission Charging Methodologies Forum (TCMF) and published a review paper and conclusions report on the issue. Ofgem stated that they were satisfied with the review undertaken by National Grid and in its conclusions report explained in enough details its proposals for the short term proposals for assets operating beyond their Replacement Period to take effect from 1 April 2002.
4. Following publication of Ofgem's conclusions on National Grid's review, National Grid proposed the Connection Charging Methodology Consultation Paper CCM-M-03 to implement the recommendations from the review conclusions. This was published on 20 November 2001 and it explained the short term process and outlined changes to the text in Chapter 7 of the Statement of the Connection Charging Methodology.
5. This conclusions report details Users' comments on the consultation document CCM-M-03 and gives National Grid's responses to these comments and our conclusions.

Consultation Document CCM-M-03

6. Modification Paper CCM-M-03, published on 20 November 2001, explained that as part of its approval of the charging methodologies, Ofgem imposed upon National Grid the condition to review its charging methodology for assets operating beyond their Replacement Period. The conclusion of the review carried out by National Grid was to propose a short term process which could be implemented for April 2002 covering assets that are already, or will become in the next charging year, 40 years old or over. In addition, the review also concluded that there was a need to develop enduring arrangements over a longer timescale. It is the short term process to which modification CCM-M-03 relates.
7. The short term process proposed by National Grid is to offer Users an Agreement to Vary the Bilateral Agreement for assets at Users sites which are, or will be in the

next charging year, over 40 years old. Therefore, for 1 April 2002 to 31 March 2003, 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 the Charging Age as of 1 April 2002 plus one year.

8. The consultation document CCM-M-03 intended to implement the conclusions from the review carried out previously (CCM-R-01). Therefore, the consultation document proposed to update Chapter 7 of the Statement of the Connection Charging Methodology in line with this short term process, described above, for 1 April 2002 to 31 March 2003.
9. Upon acceptance of this Agreement to Vary, the charges from 1 April 2002 to 31 March 2003, for assets aged beyond the Replacement Period, will solely cover ongoing site specific maintenance and Transmission Running Costs. Those Users who have entered into an agreement with National Grid will therefore, not be charged the 2.5% of GAV default charge for the charging year 2002/03.
10. The short term process outlined in CCM-M-03 is not an enduring arrangement and will only apply for the charging year 2002/03. It is the intention of National Grid that the enduring arrangements are discussed with Users and finalised over the next financial year. Enduring proposals will be consulted upon through a separate modification process. Users will then have a number of enduring options upon which they can reach agreement with National Grid. This would remove the requirement to offer such Users another Agreement to Vary the Bilateral Agreement in the following financial year. The existing options available to reach agreement with National Grid on the future arrangements for the connection site have been maintained within the methodology, i.e. Users are not obliged to wait for the enduring arrangements to be finalised to agree future arrangements.
11. Only those Users with assets operating beyond their Replacement Period who do not sign the Agreement to Vary the Bilateral Agreement and have no other relevant agreement with National Grid will be charged the 2.5% default charge on the GAV of the assets, in addition to Transmission Running Costs and maintenance charges.
12. The consultation document CCM-M-03 set out both the existing wording contained in Chapter 7 of the Statement of the Connection Charging Methodology and the proposed new wording to implement the recommendations from the review conclusions.
13. It was suggested that this proposal would better meet the Relevant Objectives in LC C7B 11(a) and 11(b) of facilitating competition in generation and supply and also of ensuring National Grid reflects the costs incurred by its Transmission Business.

Responses to CCM-M-03

14. Four written responses were received on consultation document CCM-M-03. There was also a detailed discussion at the TCMF meeting of 29 November. The written comments received are provided in Appendix 3, with a detailed response from National Grid to each of the comments.
15. In summary, a large number of the comments received were on the long term process on which National Grid has initiated discussions. Presentations on this were given at the TCMF meeting on 29 November. We have put forward a

number of different options and asked for feedback on these. Furthermore, we have asked for volunteers to act as a “sounding board” for our ideas on options for the long term process. Further discussions on the long term process will be held at the 24 January TCMF meeting. Copies of the presentations on the process and scenarios put forward for discussion are available on the TCMF page on the National Grid Industry Information web-site.

16. Of the comments received, there were a few suggested amendments to the proposed wording in Chapter 7. National Grid has taken these comments into account and are outlined in paragraph 17.

Changes To The Proposal In Light of Representations Made

17. Following the receipt of these responses from customers, National Grid proposes to make the following changes to the proposed text in Chapter 7:
 - ?? Add “and examples of these are given below in paragraph 7.5.” to paragraph 7.4 to improve clarity.
 - ?? Correct the numbering of the paragraphs in Chapter 7.
 - ?? Add to the definition in the Glossary in the draft Statement of the Connection Charging Methodology for “Charging Date” to say that the definition is in the CUSC in the Construction Agreement.
18. The proposed changes outlined above for Chapter 7 and for the Glossary are shown in Appendix 1, with the existing wording shown in Appendix 2.

Conclusions

19. In line with the conditions imposed by Ofgem in its Approval of the Use of System and Connection Charging Methodologies Decision Document, National Grid has initiated the procedure for changing the charging methodology such that the conclusions for its review of the Connection Charging Methodology for assets that are operating beyond their Replacement Period can be implemented for April 2002.
20. The methodology modification implementing the review conclusions has been commented on by Users and these comments have been considered by National Grid. As a result, we have altered the wording in paragraph 7.4 and will amend the glossary for the term “Charging Date”.
21. Therefore, National Grid concludes that it will change the wording in Chapter 7 from April 2002 as set out in Appendix 1. National Grid believes that this change better meets the Relevant Objective LC C7B 11(a) of facilitating competition in generation and supply by reducing costs and uncertainty on Users. Furthermore, we also believe that it better meets Relevant Objective LC C7B 11(b) of ensuring that National Grid reflects the costs incurred by its Transmission Business.

Appendix 1 - 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

- 7.4 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 and examples of these are given below in paragraph 7.5.
- 7.5 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:
- 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.
$$\text{Annual Charge}_n = \text{SSF}_n (\text{RPIGAV}_n) + \text{TC}_n (\text{GAV}_n)$$
 - 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.

- 7.6 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 7.5. 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.

Proposed New Wording in Glossary

Charging Date

As defined in the Construction Agreement of the Connection and Use of System Code (CUSC).

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.

Existing Wording in Glossary

Charging Date As defined in the Connection and Use of System Code (CUSC).

Appendix 3 – Comments by Users to CCM-M-03 and National Grid’s Responses

Magnox Generation Business Group of BNFL

BNFL Magnox. is generally happy with the proposed change to the charging principles document, to provide some clarity in the charging arrangements when assets are beyond the end of their charging period, particularly as a number of our sites have assets which have already, or are shortly to reach the end of their charging period. However, the current wording carries the implication that assets should be replaced at or soon after the end of the “replacement period”. Our view is that assets should only be replaced when either they need to be replaced, or because there is a commercial benefit from doing so, and not just because they are 40 years old. Replacing assets before they need to be replaced will increase costs for users of NGC’s system, and ultimately for consumers. The should be “customer choice” as far as practicable, so that users may accept a decreased reliability of connection in return for the saving from not replacing ageing assets.

National Grid’s Response

The wording in Chapter 7 of the charging methodology outlines the charging rules that would apply under the different types of agreement with Users, the status of the transmission assets at the end of the Replacement Period and the processes that have been followed under the CUSC. In the latter case, the CUSC wording [2.17.2] relates to notices given upon the expiry of the Replacement Period, hence this has to be reflected in the methodology. The intention is not to imply that replacement would occur on or shortly after the end of the Replacement Period. We agree that in determining asset replacement or for that matter any other future option, the technical requirements and User requirements need to be considered. This will be an important part of determining enduring arrangements on this part of the charging methodology.

British Energy

Below are our comments on the above consultation for consideration. We note that:-

- ?? with the Agreement to Vary (AV) in place, and the removal of the 2.5% default (risk) charge, NGC retains the liability for failure of the requisite assets within the BCA for the period from 1 April 2002 to 31 March 2003.
- ?? the current wording of Appendix 2, 7.6 defines the default charge and states that this ‘risk element’ will be removed if there is an agreement with respect to ‘replacement’. NGC has confirmed that by entering into the AV, this is an exclusive arrangement and not conditional in any respect on the User agreeing to any other initiative or proposed solution which NGC tender as possible enduring arrangements which may be proposed in the interim (revised Replacement) period.

In addition, we also note that:-

- ?? The term ‘Charging Date’ is not readily defined in the main body of the CUSC itself (not included in section 11) despite the reference in the Connection Charging Methodology, and is contained only within the generic Construction Agreement

(S2E3-5) which all Users may or may not have easy access to. Consideration should be given to include in CUSC section 11?

- ?? I note that in the Early Asset Replacement section the existing para 7.2 ends with “the new asset begins depreciation, for charging purposes, on commissioning”. The proposed wording has now substituted “the notified charging date” for “commissioning”. In the context of early asset replacement, this change does not appear to have a material effect unless there are associated reinforcement works which could therefore delay the ‘charging date’ such that it is not coincident with the ‘commissioning’ date and therefore the asset(s) would be charged as being a newer asset than it actually is by virtue of this proposed change. Please clarify the need for this change.
- ?? Suggest amending para 7.3 to clarify “ ...different types of agreement options that are available to Users which can be negotiated between NGC and the User”
- ?? In the proposed agreement option in 7.4(a) [noting that the proposal currently includes two paras. numbered 7.3] there is reference to a bilateral agreement with NGC to agree asset replacement date in the future in order to benefit from reduced connection charge (i.e.no 2.5% default). In accordance with your response to our earlier queries, this section should therefore include reference to the fact that by entering into the offered one year bilateral AV, any such agreement is not contingent on agreeing future asset replacement dates within this AV period. Any such discussions and agreement between the User and NGC need to be considered in the light of enduring arrangement proposals which may or may not be concluded within the AV period.
- ?? It would also be useful to include, possibly as an introduction to this section as a whole, for the avoidance of doubt and without prejudice to User consultation, some words about the intended process. e.g timescales; when Users will be consulted on process proposals. Proposals should also include, for example, arbitration provisions; options for, say, independent third party assessment of assets’ condition.
- ?? In the proposed 7.4(b), please define the phrase ‘no changes to some elements’. An example or two here would be helpful to clarify the intent of this proposed clause particularly as there is also reference to ‘ an additional element reflecting the relative risks.....[which] may cover the risk of additional capital charges and/or termination liabilities’. Again any accession to a ‘firm price agreement’ can only be considered with the benefit of considering the options available from an enduring asset replacement regime.
- ?? Please include within the proposed option 7.4©, which is in accordance with the currently proposed AV, that the User in entering into the AV, still retains rights to issue a counter notice in the event that NGC issue a notice to replace assets within the revised Replacement Period.
- ?? There is also a potential issue here with 7.4© associated with the ‘system security’ aspects. In the migration from MCUSA to CUSC there is now within section 2.17.3 an additional sentence which is not derived from MCUSA Appendix E and which is not considered to be a ‘codification’ of the MCUSA . The NGC amendment was introduced in the December 2000 draft CUSC without consultation with Users and potentially enhances NGC’s position with respect to Users in relation to asset replacement and ‘system security’. Whilst not directly associated with this CCM, it is an issue of principle which needs debating wider with the Authority, NGC and Users.

Notwithstanding our comments above, and whilst recognising NGC's wish to modify the CCM to take cognisance of future options for asset replacement, NGC should consider whether it is a little premature to incorporate the CCM modification as tabled. This is on the basis that it may only be appropriate at this juncture to incorporate the short term AV proposal as agreed in principle by Ofgem into the CCM. Pending wider consultation, all other options may not yet be fully identified and defined and until all options/proposals for enduring arrangements have been identified such that Users can take due consideration of all the options available to make a fully informed decision relevant to their individual circumstances, the CCM may be misleading. In addition, there is the question of the impact of the delayed debate/consultation on termination liabilities which has yet to be had and concluded. I'm sure these factors will also be considered by Ofgem in their determination

National Grid's Response

The term "Charging Date" is in the CUSC, in the Construction Agreement. We used the term CUSC as a general term encompassing the CUSC and its Exhibits. We note your comments about also including the definition in Section 11. We will expand the definition in the glossary of the charging statement (i.e. in the draft April 2002 charging statement) to say that the definition is in the Construction Agreement of the CUSC.

With reference to using "Notified charging date" instead of "commissioning", it is correct in saying that for early asset replacement there is no material effect from the change in wording and it is extremely unlikely that there will be any requirement for any associated reinforcement works. If an asset is early asset replaced then the User will be notified of the commissioning/charging date of the asset from which it will start depreciating. Furthermore, for assets replaced after the Replacement Period, it is common that there may be a number of different commissioning dates for the different assets that are being replaced. The User and National Grid will agree a charging date from which these replaced assets will start being depreciated and charged. It is unlikely that there is a large difference between the commissioning date and charging date.

The text in 7.3 refers to the example options in 7.4. We will make this clearer in the text in 7.3 (See Appendix 1 for the updated proposed text to Chapter 7).

It is confirmed that by entering into the Agreement to Vary the Bilateral Agreement, that it is not contingent on agreeing future asset replacement dates within the Agreement to Vary period. However, there are some Users that have already agreed future replacement dates and adding text referring to this may confuse them about what they have already agreed with National Grid.

It is not our intention to include a timetable for the process, in the charging statement as it is merely a reflection of the current charging methodology. The charging statement makes reference to the area of the methodology that is currently under review, i.e. the enduring process. This process, for the review of the enduring process, has been outlined at the TCMF meeting of 29 November and a copy of the presentation on the process is available on our web-site.

"No changes to some elements" refers to the charges for the asset on which a firm price has been agreed. Elements that may change are the Transmission Running Costs and maintenance charges. "An additional element reflecting the relative risk.." refers to a

premium that may be charged to cover the risks outlined in the paragraph. This wording has always been an option and is deliberately not definitive as no practical cases have arisen as yet. We agree that it should be set out in more detail and this will be part of the process in the development of the enduring scheme.

British Energy's interpretation of Option 7.4 c) is incorrect. The User does not have the right to issue a counter notice if National Grid issues a notice to asset replace within the revised Replacement Period. If, as stated in the CUSC 2.17.2, National Grid issues a notice to asset replace upon the expiry of the Replacement Period, then the User has the right to issue a counter notice. National Grid has no intention to issue replacement notices within the extended replacement period for assets. Those assets that National Grid feels need to be replaced should have already been issued with an asset replacement notice. However, if the asset fails within the Replacement Period, National Grid will discuss with the User the asset replacement.

As noted, an additional sentence was added to 2.17.3 of the CUSC in the December 2000 draft provided by National Grid as part of Ofgem/DTI's consultation process. This change was needed to ensure that National Grid was able to comply with its statutory obligations in the event that a replacement was needed for health and safety reasons despite the presence of a counter notice from a User. Without it, National Grid would have been obliged by its statutory and licence obligations to replace the asset, which would then have put National Grid in breach of the CUSC, hence putting it in licence breach. This potential licence breach is a similar concern to those that Users expressed on other issues during the development of CUSC. The change does not affect Users' rights with regard to the outcome of any counter notice issued under 2.17.2.

The change was therefore not a codification from the MCUSA and was clearly highlighted in the December draft CUSC as a new sentence not contained in the MCUSA. It was also clearly indicated as a specific addition in National Grid's final proposals document (December 2000), which accompanied the draft CUSC [paragraph 2.26 refers]. The December 2000 draft CUSC was consulted upon by Ofgem/DTI via their document of February 2001, where any issues with the draft CUSC could have been raised. Paragraph 3.40 of Ofgem/DTI document highlights the fact that National Grid have included some new sentences not contained in the MCUSA in the December 2000 draft CUSC and specifically invites comments on these.

We therefore believe that this issue and principle has already been consulted upon widely with the industry, Ofgem/DTI and National Grid.

The charging methodology reflects the short term process agreed for April 2002. The enduring process will be consulted upon and discussed at the TCMF meetings. It is not our intention to remove the option to talk to National Grid at any time about future arrangements for asset replacement at sites.

Powergen

General comment

For assets deemed to be of use beyond their agreed replacement period (e.g. 40 year usage), the User and NGC need to be satisfied of the quality and safety of such equipment based on the recommendation of an Independent Engineer/Assessor jointly appointed by the User and NGC. If there are conflicting views from NGC and the User, both sides should come to an amicable solution, preferably based on the recommendation of an Independent Engineer/Assessor.

After the replacement period (e.g. 40 years), the User has fully paid for the assets. If NGC want to continue using the asset afterwards, there should be no need for a new Bilateral Agreement, but just drop off the depreciation part (i.e. $0.025 \times \text{GAV}$) of the charge calculation leaving the maintenance and operating part of the charge. In this case NGC should bear the consequence in case of failure of the asset.

In as much as some connection assets can still operate successfully beyond their Replacement Period, clearly this is not the same saying that they can operate indefinitely. To prevent failure of operation of such assets NGC should perform a reliability assessment at an agreed interval (e.g. every 5 years) to assess the usability of the assets. In this regard there should be a clause in the CUSC (i.e. Section 2.14) to clearly indicate this interval.

If a site, for example a power station, is about to be closed and NGC wants to install new assets after the expiry period of the old asset, NGC should be liable to carry the full cost of the new asset(s) after the station closure.

NGC should start discussions for replacement of assets near the end of their replacement period, say 18 months before the expiry time.

Specific comments are as follows:

Appendix 3 - Section 7.4 a

In determining the Annual Assets Charge, the new Gross Asset Value (GAV) should be re-valued based on the recommendation of an Independent Assessor/Engineer jointly appointed by NGC and the User.

Appendix 3 - Section 7.4 d

The formula to calculate the Annual Charge in the absence of agreement between NGC and User should be changed to:

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

The original proposal attempts to fix a penalty on Users for failure to agree terms for charging beyond the asset replacement period. This presumes that the User is the unreasonable party in the negotiations and should therefore be incentivised to play ball. This is not a robust assumption and there is no reason why the User should continue to pay towards the capital cost of the asset indefinitely.

National Grid's Response

General Comments

We agree that in defining the enduring arrangements it will be important to set out clearly within the CUSC what the process is for agreeing future operation and plans for sites that are approaching the end of their Replacement Period. We agree that ideally the process of discussion should be initiated well in advance of the end of the Replacement Period.

We also agree that, in these enduring arrangements, there should not be a need to issue a Bilateral Agreement to extend the Replacement Period and that the obligations on National Grid and charging liabilities on Users should be clear. However, we are not in this position at present, hence the proposed short term process of a Bilateral Agreement to Vary to remove the 2.5% default charge.

On specific comments:

Appendix 3 - Section 7.4 a

We do not agree with this comment. As the charges relate to an existing asset which already has an established GAV, we believe this is the GAV that should be used and re-valued in line with the indexation method appropriate for the asset. This ensures that the same methodology is applied to all assets. There is no reason why the basis of the GAV should change if the asset is still operational after the end of the Replacement Period.

Appendix 3 - Section 7.4 d

We agree with the sentiment of the argument put forward but we do not believe this to be the case with the short term process outlined and hence do not agree with the proposed suggested change to the formula. Given an Agreement to Vary has been proposed to all Users with assets which will or already are operating beyond 40 years, the 2.5% charge will only apply to those sites where Users explicitly refuse to sign the Agreement to Vary. We note that PowerGen do not have any sites of this nature. We do not envisage that any Users will not sign the Agreement to Vary so we would hope that this clause is redundant. One of the objectives of designing the enduring arrangements is to ensure that we do not need clause 7.4d.

These points are reflected in this modification and we will ensure that your general comments are picked up in the ongoing review to determine enduring arrangements in this area of the charging methodology.

Innogy

Background to the Issues

NGC's consultation paper sets out a proposed modification to the Connection Charging Methodology that would implement their proposals for a short-term process for assets operating beyond their Replacement Period. It is claimed that this process will better meet the relevant objectives of facilitating competition in the generation and supply of electricity (LCC7B (a)), and ensuring National grid reflects the costs incurred by its Transmission Business (LCC7B (b)).

In describing the background to the issues NGC claim that the process described in CCM-R-01 had been accepted by Ofgem. However, Ofgem's Response to NGC's short-term proposals does not reach this position. In their Response, which is lodged on NGC's web site, Ofgem say "*Ofgem is satisfied with the review that NGC has undertaken and that NGC has explained in sufficient detail the reasons for its short term proposals.*" It then goes on to comment on the need for NGC to manage a safe and secure system, and note that it is unable to form a view on NGC's enduring arrangements. Unlike the responses Ofgem made to the other issues reviewed by NGC at the same time it did not "**agree**" that NGC's short-term process is necessarily appropriate.

Our view is that NGC's suggested short-term process meets neither of the Relevant Licence Objective as has been suggested for the reasons discussed below.

2.5% Risk Factor

The "Replacement Period" of an asset is defined as *"the period ... after which it is assumed for accounting purposes such NGC asset will need to be replaced, [and] which shall be 40 years unless otherwise agreed..."*. The significance of the Replacement Period is that it is the period of time over which NGC recovers the initial capital cost of the asset at a rate of 2.5% of the GAV in accordance with the relevant charging principle. NGC argue that if the asset is not replaced and there is no agreement with the User, then NGC incurs an additional "risk" which coincidentally has a cost that is also 2.5% of the GAV. However, this additional risk has never been described nor its quantification explained. We cannot see why any additional risk to NGC should arise under these circumstances and thus why NGC incurs any additional cost, with a consequent need to charge Users.

If NGC were permitted to increase the charge for the connection asset by this amount then it would over-recover the cost of the asset since at the 40th year the asset would be fully depreciated. Thus changing the charging methodology in this manner would appear contrary to the relevant objective of cost reflection. Generally the User will have a natural incentive after 40 years to see the most economic choice made between asset retention and asset replacement since an ageing asset will tend to have a rising maintenance cost which the User will be required to pay.

Process

The main deficiency in the Charging Methodology is that the procedure concerning the treatment of assets whose life has exceeded the Replacement Period is unclear. The current drafting assumes that the choice is only between retention or replacement. However, the normal circumstance once the Replacement Period has expired, is that the configuration of assets at a connection site is no longer appropriate for the duty required. A more useful approach would be for NGC to be required to conduct a thorough assessment of the situation as part of its consultation with affected parties

In our response to NGC's consultation CCM-R-01 dated 8th August 2001, we suggested that if NGC wishes a connection asset to be renewed then:

- (i) NGC should be obliged to produce a Condition Assessment statement for a connection site indicating the rationale for replacement. The Condition Assessment Statement should include costs such that the User can make a reasonable estimate of future site charges once the asset has been replaced. This should be open to review by an Independent Engineer, whose opinion should be binding subject to appeal to the Authority.
- (ii) After the Condition Assessment Statement has been produced there should be a period of consultation with the User. This should be of a sufficient length that the User can contemplate the options of
 - ☞ undertaking his own engineering works such that he no longer has need for the asset to be replaced;
 - ☞ enter into negotiation with other potential sources of electricity that would negate the need for the connection;
 - ☞ issuing the relevant notices to terminate the connection if this were the most economic route for the User.

The present period of 3 months prescribed in paragraph 2.17.2(ii) of the CUSC provides insufficient time for any of these options to be considered fully. Arguably the above process should be embraced whenever asset replacement is contemplated whether or not the asset has reached 40 years.

Only if the process permits the most economic connection arrangements to emerge can NGC be said to have facilitated competition in electricity generation and supply and thus met the relevant licence Objective. Adoption of the approach suggested above would seem to have the added bonus of furthering the Licence Objective of *“facilitating competition in the carrying out of works for connection to National Grid’s Transmission system”*.

National Grid’s Response

Status of Review Approval

Ofgem imposed a condition on National Grid, as part of their approval of the initial Connection Charging Methodology, that it should review the Connection Charging Methodology regarding assets that are operating beyond their Replacement Period. The condition stated that National Grid should provide a report to Ofgem of its review, with reasons in reasonable detail for its conclusions and to initiate the procedure for changing the Connection Charging Methodology, if appropriate, so that any change could take effect from April 2002.

National Grid has followed the above condition and Ofgem agreed that they were satisfied with the Review and that National Grid’s conclusions were in sufficient detail to merit the conclusions they had reached. If Ofgem had not been satisfied with the conclusions or that National Grid had not explored all the options, they presumably would have requested that National Grid pursue other options or further detail as to what could be implemented for April 2002.

The charging methodology modification was put in place to implement the review conclusions for April 2002. Consultation on this modification should be focused on whether the modification effectively implements the conclusions.

2.5% Risk Factor

We are unsure of the point being made here. The reason for the implementation of the short term process is to put in place a mechanism which avoids the need to levy any default 2.5% charge. Therefore, by the Users’ comments, this would better meet the objectives.

The rationale for this charge was outlined in the review paper CCM-R-01 and was also discussed at the Transmission Charging Methodologies Forum meeting in November. In its Decision Paper, Ofgem acknowledged that National Grid faced a risk. Furthermore, National Grid noted in its review paper CCM-R-01 that it agreed 2.5% did not reflect the risk incurred as it was just a default charge in the absence of any other agreement. It therefore suggested that the best way forward was to try and put in place arrangements that meant the risk was removed and hence no default charges needed to be applied. This is what is achieved by the short term process.

These points will need to be considered in the development of enduring arrangements with regard to assets that are operating beyond their Replacement Period. We agree that the process of gaining agreement on the future operation of a site and the options

available to the User need to be clearly set out and detailed in the CUSC and charging statements. This process is already underway and we have sought Users help in developing this process further. Therefore, we do not believe that these comments are relevant to the modification CCM-M-03.