Direct Dial: 020-7901-7412

14 February 2003

The National Grid Company, CUSC Signatories and
Other Interested Parties

Our Ref: UoSCM-M-09

Dear Colleague

Decision in relation to Use of System Charging Methodology Modification Proposal UoSCM-M-09: "Proposal to use new capacity term as introduced by CAP043 CUSC amendment for Generation TNUoS charges"

The Gas and Electricity Markets Authority (the "Authority")[1] has carefully considered the issues raised in the Conclusions Report[2] in respect of the Use of System Charging Methodology Modification Proposal UoSCM-M-09: "Proposal to use new capacity term as introduced by CAP043 CUSC amendment for Generation TNUoS charges".

The National Grid Company plc ("NGC") submitted the Conclusions Report to the Authority on 13 February 2003 and recommended to the Authority that the amended Modification Proposal UoSCM-M-09 should be implemented.

Ofgem has decided not to veto amended Modification Proposal UoSCM-M-09. Amended Modification Proposal UoSCM-M-09 will therefore be implemented on 1 April 2003 as set out in the Conclusions Report.

This letter sets out the background to the Modification Proposal and sets out the Authority's reasons for its decision.

---

[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-09, "Proposal to use new capacity term as introduced by CAP043 CUSC amendment for Generation TNUoS charges", dated 13 February 2003.

Background

At present generation Transmission Network Use of System ("TNUoS") charges for the financial year are based on Chargeable Generation Capacity net of the average Station Load[3] metered at Triad[4]. England and Wales are divided into positive and negative zones for generation TNUoS charging purposes. Generators[5] situated in positive charging zones pay the relevant TNUoS charges and generators situated in negative charging zones receive the relevant TNUoS payments. In positive charging zones the Chargeable Generation Capacity is the sum of the highest Generation Capacity submitted for settlement purposes by each Balancing Mechanism Unit ("BMU") from the beginning of April to the end of February. In negative charging zones the Chargeable Generation Capacity is the average of the capped (by the Generation Capacity) metered volumes during the three Settlements Periods between November and February which have the highest metered volumes for each BMU.

On 20 September 2002 NGC submitted Connection and Use of System Code ("CUSC") Amendment Proposal CAP043 "Transmission Access - Definition". CUSC Amendment Proposal CAP043 sought to introduce and define clear and unambiguous capacity entry products and associated terminology in the CUSC. Specifically, the Amendment Proposal sought to introduce two new terms, Connection Entry Capacity ("CEC") and Transmission Entry Capacity ("TEC"), to the CUSC. The CEC defines the physical capacity of the generator at the connection point in line with what they have contractually requested. The TEC will define a generator's maximum allowed export onto the transmission system ("System") in a financial year. NGC propose using TEC in its planning studies to determine the wider System infrastructure requirements and as the basis for generation TNUoS charges by amending the associated Use of System Charging Methodology. NGC submitted the Amendment Report for CUSC Amendment Proposal CAP043 to the Authority for consideration on the 23 December 2002 and recommended that the Alternative[6] Amendment Proposal CAP043 should be made and implemented on 1 April 2003.

On the 11 November 2002 NGC issued a Consultation Paper on Modification Proposal UoSCM-M-06 "Proposal to use new capacity term as introduced by CAP043 CUSC amendment for generation TNUoS charges" to the Use of System Charging Methodology. Modification Proposal UoSCM-M-06 sought to modify the Use of System Charging Methodology to change the generation TNUoS charging basis to utilise the TEC rather than the Chargeable Generation

[3] The Station Load is equal to the sum of the demand of BM Units solely comprising the Station Transformers within the Power Station. For the avoidance of doubt, Station Load excludes BM Units comprising Additional Load.

[4] The Triad is the three settlement periods of highest System demand in a financial year, namely the half hour Settlement Period of System peak demand and the two half hour Settlement Periods of next highest demand, which are separated from the System peak demand and from each other by at least 10 clear days, between November and February of the financial year inclusive.

[5] Generation TNUoS charges can also apply to interconnectors.

[6] Following the industry consultation for original Amendment Proposal CAP043 and in the light of responses received, NGC developed an Amended Amendment Proposal that it considered better facilitated achievement of the Applicable CUSC Objectives as compared to the original Amendment Proposal.

Capacity as is currently used. NGC proposed that generation TNUoS charges in a positive charging zone would be based on the highest TEC in the financial year.

In addition, NGC proposed an amendment to the method for calculating TNUoS payments to generators in negative tariff zones. NGC proposed to take for each month between November and February of the relevant financial year the volume of the Settlement Period with the highest metered volumes (capped by TEC) for each Power Station. These four volumes would then be averaged to determine the TNUoS payment. This is a different method to the present arrangements, which take the three Settlement Periods with the highest metered volume for each BMU (capped by Generation Capacity) between November and February which are separated from each other by at least 10 clear days.

Respondents' views to consultation on Modification Proposal UoSCM-M-06

NGC received 10 responses to the consultation on Modification Proposal UoSCM-M-06. Four respondents supported the use TEC for charging purposes in the event that the CUSC Amendment Proposal CAP043 is approved. The remaining six respondents did not support Modification Proposal UoSCM-M-06.

Two respondents that did not support Modification Proposal UoSCM-M-06 considered that TEC would be a less cost reflective parameter than Generation Capacity on which to base generation TNUoS charges. One of these respondents considered that TEC would be less precise in measuring a generator's System usage because it cannot track the System needs of the generator's output in the same way that Generation Capacity can. The other respondent considered that the Modification Proposal will shift the balance of risk from NGC onto generators who will have to forecast their amount of usage of the System, and to pay for that capacity whether they use it or not. This respondent considered that the Modification Proposal is potentially discriminatory as it is asymmetrical with the requirements for demand TNUoS charges where suppliers forecast their expected usage and then pay for the actual usage.

One respondent was concerned that, under the current provisions of the CUSC, if two parties were to trade access rights, then unless this transaction were aligned with the financial year then both parties would incur generation TNUoS charges on the traded capacity and the capacity would be double counted which is not appropriate. This respondent also suggested that there could be circumstances whereby parties incur generation TNUoS charges for TEC which they have applied for but which has not yet been made available to them.

One respondent considered that the proposed changes to the method for determining payments in negative charging zones would be more accurate. Three respondents did not support the proposed changes to the method for determining payments in negative charging zones. In general these respondents argued that the change would not encourage greater availability over the winter months because the Modification Proposal does not reflect generators availability

over the entire month but the highest maximum volume for only a Settlement Period in each month.

NGC's view on Modification Proposal UoSCM-M-06

NGC submitted a Conclusions Report for Modification Proposal UoSCM-M-06 on the 23 December 2002. NGC recommended to the Authority that Modification Proposal UoSCM-M-06 should be made. NGC considered that the use of TEC for charging purposes would be more cost reflective and that Modification Proposal UoSCM-M-06 would better facilitate the achievement of the Relevant Objectives[7] of the Use of System Charging Methodology.

The Authority's Decision on Modification Proposal UoSCM-M-06

On the 15 January 2003 the Authority vetoed Modification Proposal UoSCM-M-06 to the Use of System Charging Methodology. The Authority was not certain it would be in a position to approve or reject CUSC Amendment Proposal CAP043 before the expiry of the 28 day period by which NGC must implement Modification Proposal UoSCM-M-06 unless directed otherwise by the Authority. The Authority considered that it would be inappropriate for it not to veto Modification Proposal UoSCM-M-06 before the Authority had made a decision to approve or reject CUSC Amendment Proposal CAP043. This was because to allow Modification Proposal UoSCM-M-06 to be made may have fettered the Authority's discretion in respect of CUSC Amendment Proposal CAP043 or alternatively, subject to the outcome of the Authority's deliberations with regard to CUSC Amendment Proposal CAP043, the Use of System Charging Methodology change could have become inappropriate.

The Modification Proposal UoSCM-M-09

On the 6 February 2003 the Authority approved CUSC Alternative Amendment Proposal CAP043. On the same day NGC wrote to Ofgem indicating that it intended to resubmit Modification Proposal UoSCM-M-06 as Modification Proposal UoSCM-M-09 and recommended

---

[7] The Relevant Objectives of the Connection Charging Methodology, as contained in Condition C7B.11 of National Grid Company's Transmission Licence (the "Transmission Licence"), are:

(a) the objectives referred to in paragraph 5 of standard condition C7A (Use of System Charging Methodology), as if references therein to the use of system charging methodology were to the connection charging methodology; and

(b) in addition, the objective, in so far as consistent with sub-paragraph (a), of facilitating competition in the carrying out of works for connection to the licensee's transmission system.

The Relevant Objectives of the Use of System Charging Methodology, as contained in Condition C7A.5 of the Transmission Licence are:

(a) that compliance with the use of system charging methodology facilitates effective competition in the generation and supply of electricity and (so far as is consistent therewith) facilitates competition in the sale, distribution and purchase of electricity;

(b) that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs incurred by the licensee in its transmission business; and

(c) that, so far as is consistent with sub-paragraphs (a) and (b), the use of system charging methodology, as far as is reasonably practicable, properly takes account of the developments in the licensee's transmission business.

that Licence Condition C7A 3(a) which requires NGC to consult CUSC users on any Modification Proposals and to allow them a period of not less than 28 days within which to make representations should not apply. On the same day Ofgem replied to NGC and directed under Licence Condition C7A 3(d) that for Modification Proposal UoSCM-M-09 the consultation period under C7A 3(a) shall be 2 working days instead of 28 days. This was on the basis that NGC stated that the views to the 28 day consultation already undertaken on Modification Proposal UoSCM-M-06 would be taken into account and that a longer period would not allow sufficient time to agree TEC and CEC figures required for the implementation of CUSC Alternative Amendment Proposal CAP043.

The original Modification Proposal UoSCM-M-09 is identical to Modification Proposal UoSCM-M-06 except for a minor amendment to the proposed changes to the Use of System Charging Methodology text to simplify the requirements for data provision by generators and interconnector asset owners in regard to TEC.

NGC issued a consultation paper on Modification Proposal UoSCM-M-09 on 7 February 2003 inviting responses by 12:00 midday on 11 February 2003.

Respondents' views on Modification Proposal UoSCM-M-09

NGC received five responses to the consultation on Modification Proposal UoSCM-M-09. Two respondents supported the use TEC for charging purposes to ensure consistency with approved CUSC Alternative Amendment Proposal CAP043. The remaining three respondents did not support Modification Proposal UoSCM-M-09.

Three responses reiterated their concerns over the proposed new treatment of generation in negative charging zones. Two respondents suggested that the same method for calculating capacity should be used for all generation regardless of whether it is sited in a positive or negative charging zones. Another respondent suggested that the proposed change moves further away from a capacity based charge to a charge based on actual usage of the network.

Two respondents suggested that the proposed change to the method for calculating TNUoS payments to generators in negative tariff zones should have been subject to a separate Modification Proposal, on the basis that the change was not connected with the changes required as a result of CUSC Alternative Amendment Proposal CAP043. One of these respondents suggested that this element should be removed from Modification Proposal UoSCM-M-09.

NGC's view on Modification Proposal UoSCM-M-09

NGC considered that the proposed method for determining TNUoS payments to generators in negative tariff zones would better meet its Transmission Licence objectives by more accurately

reflecting the impact of generation in those zones on transmission investment. However, NGC recognised that the proposed change to the method for calculating TNUoS payments to generators in negative tariff zones is not contingent on the introduction of TEC. In order to expedite a decision on the elements that relate to TEC, NGC decided to remove the elements of the Modification Proposal that relate to the proposed change to the method for determining TNUoS payments to generators in negative tariff zones. As NGC considered that the proposed method for determining TNUoS payments to generators in negative tariff zones would better meet its Transmission Licence objectives, it intends to issue a new Modification Proposal on negative tariff zones in the near future.

NGC considered that following the approval of CUSC Alternative Amendment Proposal CAP043 the generation TNUoS charging basis should be changed to utilise the TEC. NGC considered that using TEC would lead to more cost reflective generation TNUoS charges. NGC stated that following the implementation of the CUSC Alternative Amendment Proposal CAP043, TEC will be the measure used for the purposes of transmission planning, and so there will be a direct link between TEC and transmission investment costs. In addition, NGC considered that capacity is currently defined as an annual product and therefore it is appropriate at this time for TNUoS charges to be based on annual capacity.

NGC considered that it is appropriate to levy generation TNUoS charges and payments on the basis of capacity rather than usage of the System as transmission costs are driven by the capacity required by users of the System rather than actual usage. NGC did not consider that the different approach for generation and demand TNUoS charges unduly discriminates. NGC suggested that generation and demand do not compete directly with each other, and therefore there is no distortion in competition caused by different treatment. In addition, NGC highlighted that generators are treated consistently for generation TNUoS charges, as are suppliers for demand TNUoS charges.

NGC considered that amended Modification Proposal UoSCM-M-09 bases TNUoS charges on a clearly defined entry capacity product which would better facilitate achievement of the Relevant Objective of the Use of System Charging Methodology C7A 5(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.

NGC considered that using a new capacity measure which clearly defines the System entry rights would better facilitate achievement of the Relevant Objective of the Use of System Charging Methodology C7A 5(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.

In addition, NGC considered that the amended Modification Proposal reflects the changes to CUSC to be implemented by CUSC Alternative Amendment Proposal CAP043 which would better facilitate achievement of the Relevant Objective of the Use of System Charging Methodology C7A 5 (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.

NGC recommended to the Authority that the amended Modification Proposal UoSCM-M-09 should be made and implemented from 1 April 2003.

Ofgem's view

Ofgem considers, having had regard to its statutory duties, that the amended Modification Proposal UoSCM-M-09 would better facilitate achievement of the Relevant Objectives of the Use of System Charging Methodology.

Ofgem agrees with NGC that the proposed changes to the method for determining generation TNUoS payments in negative charging zones should be considered as a separate Modification Proposal as they are not directly associated with the new terms to be implemented by CUSC Alternative Amendment Proposal CAP043. NGC can resubmit the proposed changes to the method for determining generation TNUoS payments in negative charging zones as a separate Modification Proposal in accordance with the procedures in Condition C7A of the transmission licence.

Relevant Objective of the Use of System Charging Methodology C7A 5 (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.

In its decision letter on CUSC Amendment Proposal CAP043 the Authority agreed with NGC that the proposed changes to the CUSC to introduce TEC and CEC rationalise the different capacity terminology used throughout the CUSC, making it clear what rights and obligations flow from each capacity product. Ofgem also considered that the proposed CUSC terminology changes would help provide clarity to market participants as compared to the present capacity definitions. Ofgem agrees with NGC that basing generation TNUoS charges on a clearly defined entry capacity product would provide clarity to market participants and promote competition.

Therefore Ofgem considers that the amended Modification Proposal UoSCM-M-09 will better facilitate the achievement of the Relevant Objectives of the Use of System Charging Methodology C7A 5 (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.

Relevant Objective of the Use of System Charging Methodology C7A 5 (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.

NGC considers that the use of TEC for the purposes of charging would be more cost reflective as TEC will be the measure used for the purposes of transmission planning, and so there will be a direct link between TEC and transmission investment costs. Ofgem considers that NGC's charges for connection and use of system should be cost reflective to prevent discrimination to users. Ofgem agrees with NGC that TEC should be used for the purposes of charging to make charges more cost reflective and to prevent discrimination.

Therefore Ofgem considers that the amended Modification Proposal UoSCM-M-09 will better facilitate the achievement of the Relevant Objectives of the Use of System Charging Methodology C7A 5 (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.

Relevant Objective of the Use of System Charging Methodology C7A 5 (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 amended Modification Proposal UoSCM-M-09 reflects the changes introduced by the approved CUSC Alternative Amendment Proposal CAP043. Therefore Ofgem considers that the amended Modification Proposal will better facilitate the achievement of the Relevant Objective of the Use of System Charging Methodology C7A 5 (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.

One respondent to the consultation on Modification Proposal UoSCM-M-06 suggested that there could be circumstances when a traded TEC is double counted for TNUoS charging purposes and whereby parties incur TNUoS charges for TEC which they have applied for but which has not yet been made available to them. Ofgem sought confirmation from NGC that these circumstances would not occur. NGC confirmed that they would not double count a traded TEC for TNUoS charging purposes and that a party would not incur TNUoS charges for TEC which they have applied for but which has not yet been made available to them.

NGC stated that it is appropriate to levy generation TNUoS charges on the basis of capacity rather than usage of the System as NGC's transmission costs are driven by the capacity required by users of the System rather than actual usage. Ofgem notes that this is not the case for

demand TNUoS charges which are based on actual usage. However, in deciding upon any Modification Proposal, Ofgem has to consider not whether the Modification Proposal represents the best possible method for achieving the Relevant Objectives but merely whether the Modification Proposal would better facilitate their achievement. That is, Ofgem can only consider the impact of the Modification Proposal that comes to it for determination. Consequently, it would not be appropriate to reject a Modification Proposal because it did not address all aspects of an issue, if the issues that are addressed would lead to the better facilitation of the Relevant Objectives. As outlined above, Ofgem considers that the amended Modification Proposal does better facilitate the achievement of the Relevant Objectives of the Use of System Charging Methodology.

NGC has indicated at the Transmission Charging Methodology Forum that it will, consistent with its Transmission Licence obligations, keep under review a number of aspects of its charging methodologies.

The Authority's Decision

The Authority has therefore decided to not veto amended Modification Proposal UoSCM-M-09. Amended Modification Proposal UoSCM-M-09 will therefore be implemented on 1 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. Alternatively, contact Richard Ford on 020 7901 7411.

Yours sincerely

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