



Direct Dial: 020-7901-7008

10 September 2004

The National Grid Company, CUSC Signatories and  
Other Interested Parties

Our Ref: UoSCM-M-13

Dear Colleague

**Decision in relation to use of system charging methodology modification UoSCM-M-13:  
Introducing a new charge for short-term transmission access.**

The Gas and Electricity Markets Authority (the Authority) has carefully considered the issues raised in the Conclusions Report<sup>1</sup> in respect of the proposed use of system charging methodology modification<sup>13</sup> (UoSCM-M-13) *Introducing a New Charge for Short-Term Transmission Access*.

The National Grid Company plc (NGC) submitted the Conclusions Report to the Authority on 16 August 2004. NGC recommended to the Authority that the statement of the use of system charging methodology and the statement of the use of system charges be amended, should the Authority decide to approve CUSC Amendment Proposal 070 (CAP070), to include charging for short-term transmission entry capacity (STTEC).

In the Conclusions Report NGC noted that under the transmission licence condition C7 5(a) it is normally required to provide the Authority with 150 days notice of any proposal to amend Transmission Network Use of System (TNUoS) charges<sup>2</sup>, as well as providing generators with at least two months notice of any revised TNUoS charges<sup>3</sup>. However, NGC suggested that the modification be implemented in time for winter 2004/05 and said that implementation of the charging modification proposal and associated revised TNUoS charges would require the Authority to waive the notice periods. NGC proposed that:

- if the Authority were not to waive the 150 day notice period, implementation would occur on 1 February 2005, with the application fee being effective from 10 January 2005;
- if the Authority were to waive the 150 day notice period but not the two month notice period, implementation is proposed as of 1 December 2004, with the application fee being effective from 10 November 2004; and

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<sup>1</sup> Conclusions Report to the Authority, Modification Proposal to the Use of System Charging Methodology, UoSCM-M-13. 'Introducing a new charge for Short-term Transmission Access, dated 13 August 2004'. The Conclusions Report is available at <http://www.nationalgrid.com/uk/indinfo/charging/pdfs/ConclusionReportUoSCM-M-13.pdf>

<sup>2</sup> This is now transmission licence condition 4 5(a) of the new standard transmission licence conditions which came into effect on 1 September 2004

<sup>3</sup> Section 3.14 of the Connection and Use of System Code

- if the Authority were to waive both the 150 day notice period and the two month notice period, implementation is proposed as of 1 November 2004, with the STTEC application fee being effective as of one day after the date of the Authority's decision.

The Authority approves of the proposed UoSCM-M-13 as it considers that it better facilitates the achievement of the applicable objectives<sup>4</sup> as set out under standard condition C5 5 of NGC's transmission licence, and so will not exercise its powers of veto. Given the potential importance of short-term transmission access the Authority considers it reasonable to grant a waiver in relation the requirement to provide notice of amendments to charges in this circumstance and for the modification to be implemented on 1 November 2004.

This letter sets out the background to the modification proposal, explains the proposed modification and its interaction with Connection and Use of System Code (CUSC) Amendment Proposal 070 (CAP070), summarises respondents' views and sets out Ofgem's reasons for its decision.

## **Background**

CAP070 would introduce a short-term firm access product, allowing generators who have a station connection entry capacity (CEC) greater than their registered TEC, to purchase blocks of STTEC during the course of a year. Ofgem issued its decision to accept the proposed alternative amendment on 10 September 2004<sup>5</sup>.

The charging methodology for purchasing blocks of STTEC has been developed in a separate use of system charging methodology consultation, UoSCM-M-13, which progressed concurrently to the consultation on CAP070.

CAP070 was raised by NGC and submitted for consideration by the CUSC amendments Panel (the Panel) on 23 January 2003. The Panel determined that it should be evaluated by a working group, which reported back on 21 May 2004. The working group also raised an Alternative Amendment Proposal to introduce a short notice short-term firm product (SNSTF). Both of the Proposals proceeded to wider industry consultation<sup>6</sup>. The final report was submitted to the Authority for determination on 19 July 2004.<sup>7</sup>

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<sup>4</sup> The Relevant Objectives of the Use of System Charging Methodology, as contained in condition C5 5 of the standard 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.

<sup>5</sup> The Authority's Decision Letter in regard to CAP070 is available at [www.ofgem.gov.uk](http://www.ofgem.gov.uk)

<sup>6</sup> The consultation document in regard to CAP070 is available at <http://www.nationalgrid.com/uk/indinfo/cusc/admin/scripts/uploads/CAP070%20-%20Consultation%20Document%20-%20Version%201.0.pdf>

<sup>7</sup> The amendment report in regard to CAP070 is available at <http://www.nationalgrid.com/uk/indinfo/cusc/admin/scripts/uploads/CAP070%20-%20Amendment%20Report%20-%20V1.0.pdf>

## The Proposed Modification

Modification UoSCM-M-13 proposes to change the use of system charging methodology to allow NGC to charge for short-term entry capacity in the event that a user submits a request for STTEC/SNSTF in accordance with the CUSC, as set out in the Alternative Amendment Proposal raised under CAP070.

NGC proposed that a daily STTEC/SNSTF charge for generation in positive charging zones<sup>8</sup> (with a zero charge for generation in a negative tariff zone) would be based on 90 per cent of the zonal tariff<sup>9</sup> pro rated over a winter period of 120 days as expressed by the formula:

$$\frac{TGi \times 0.9 \times \text{STTEC Period}}{120} = \text{STTEC tariff (£/kW/period); in positive charging zone}$$

0; in negative charging zone

Where:

FT = Final annual TNUoS Tariff expressed in £/kW

Gi = Generation Zone

STTEC Period = A period applied for in days as defined in the CUSC

STTEC/SNSTF would only be available where it would not exacerbate any existing system constraint. NGC considered that, despite the marginal infrastructure cost being zero, it is appropriate to charge for STTEC/SNSTF at a level which would not undermine TEC as the primary method of charging for system usage and hence would not weaken investment signals. STTEC/SNSTF would not feed into the model used to calculate TNUoS tariffs, as there would be considerable uncertainty over the likely usage of STTEC/SNSTF at the beginning of a charging year.

The modification proposes an application fee to cover the costs of studies undertaken by NGC to assess each request for STTEC/SNSTF. The fee would be defined in the CUSC and published in the statement of the use of system charges. This fee would be fixed, non-refundable and based on the current fee for increasing TEC. NGC noted that the level of the application fee may merit further consideration in future.

The modification proposes to amend sections 3, 5 and 7 of the statement of the use of system charging methodology, as well as appendix TN-6, to include a definition of STTEC/SNSTF, the formula for its calculation and details of the treatment of positive and negative charging zones. Additionally, Appendix 1 of the statement of the use of system charges will be updated to include short-term generation tariffs.

## Respondents' views

NGC issued a consultation paper on 9 June 2004<sup>10</sup> inviting responses from CUSC parties and interested parties by 7 July 2004. NGC received nine responses to the consultation on UoSCM-M-13, all of which were unsupportive of the proposal or aspects of the proposal. Respondents' views are summarised and contained in the Conclusion Report on UoSCM-M-13. A summary of views is set out below.

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<sup>8</sup> For details of generation charging zones see [http://www.nationalgrid.com/uk/indinfo/charging/mn\\_useful\\_info.html](http://www.nationalgrid.com/uk/indinfo/charging/mn_useful_info.html)

<sup>9</sup> Zonal Tariffs for 2004/05 are available at [http://www.nationalgrid.com/uk/indinfo/charging/pdfs/2004\\_5\\_TNUoS\\_Tariffs.pdf](http://www.nationalgrid.com/uk/indinfo/charging/pdfs/2004_5_TNUoS_Tariffs.pdf)

<sup>10</sup> The consultation document in regard to UoSCM-M-13 is available at [http://www.nationalgrid.com/uk/indinfo/charging/pdfs/UoSCM-M-13\\_Short\\_Term\\_Access%20.pdf](http://www.nationalgrid.com/uk/indinfo/charging/pdfs/UoSCM-M-13_Short_Term_Access%20.pdf)

### *Cost Reflectivity*

The majority of respondents considered that it was inappropriate to state that STTEC/SNSTF is a winter only product and claimed that if NGC considered that 90 per cent of costs occur during peak, STTEC/SNSTF should be available at 10 per cent of TNUoS during non-peak periods. The asymmetry between positive and negative charging zones (where STTEC/SNSTF is priced at zero) was also noted. Two respondents commented that given STTEC/SNSTF will only be granted if the marginal cost is zero any charging regime cannot be cost-reflective.

Respondents also stated that the overall cost reflectivity of TNUoS charges would be reduced as STTEC/SNSTF would not be used in the calculation of annual tariffs. This would increase charges for other generators and would be anti competitive, send misleading investment signals and potentially creating incentives for more plant to mothball.

### *Facilitating Competition*

Respondents considered that the proposed charging arrangements would not facilitate competition as they would discriminate between users in negative and positive charging zones. It was also stated that the proposal would amount to a cross subsidy from baseload generators to marginal peaking plants.

One user considered that the STTEC/SNSTF charge would be too high and this would discourage generators accessing the network on a short term basis.

### *Interaction with TEC*

Several respondents stated that the proposal was inconsistent with the method of charging for TEC. It was suggested that, in an effort to avoid incentives to reduce TEC, a penal charging structure had been developed.

Other respondents suggested that the migration of generators from TEC to STTEC/SNSTF would weaken the investment signals from TEC.

### **NGC's view**

NGC considered that the proposal would better achieve the relevant charging methodology objectives by:

- ensuring appropriate treatment between Users incurring TNUoS generation charges
- ensuring that TEC remains the primary basis for TNUoS charges levied to gain access to the system and that STTEC/SNSTF charges do not undermine the investment signal derived from the demand for TEC
- levying a cost-reflective application fee, and
- ensuring the charging methodologies reflect developments within NGC's Transmission Business.

NGC attempted to address a number of the respondents' concerns in the Conclusions Report.

### *Cost Reflectivity*

NGC responded to concerns raised about the cost reflectivity of the STTEC/SNSTF charge by stressing the need to consider how any STTEC/SNSTF product would interact with TEC. It emphasized the need to ensure that any charge would not undermine TEC but nevertheless create a short-term access product that would be attractive to generators.

### *Facilitating Competition*

NGC considered that there would not be significant migration from TEC to STTEC/SNSTF. NGC stated that the charging methodology proposal would allow users to respond to market signals without paying proportionally more than generators located within the same charging zones, hence avoiding discrimination between users.

### **Ofgem's view**

The introduction of UoSCM-M-13 would better achieve the relevant objectives of the use of system charging methodology, as set out below.

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

The proposed modification UoSCM-M-13 would facilitate effective competition in generation by setting a charge for an additional access product that:

- should allow generators to access the market on a short term basis;
- does not undermine the use of TEC as the primary charging product, hence avoiding the dilution of longer-term investment signals based upon annual TEC requests.

Relevant objective b - that compliance with the use of system charging methodology results in charges which reflect, as far as is reasonably practicable, the costs incurred by the licensee in its transmission business.

Ofgem notes respondents concerns with regard to the cost-reflectivity of the STTEC/SNSTF charge and considers that going forwards there may be merit in users and NGC reviewing the structure of the charge, to improve cost reflectivity. However, there are inherent difficulties in developing cost-reflective charging arrangements for a product with a low short term marginal cost, while ensuring that arrangements for the cost reflective charging of TEC are not destabilised.

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

The modification to the use of system charging methodology will provide a charging mechanism for the sale of STTEC/SNSTF as set out under alternative amendment proposed under CAP070, and hence properly takes account of developments in the licensee's transmission business.

### **The Authority's Decision**

The Authority approves of the proposed UoSCM-M-13 and therefore directs that it shall be made. The Authority considers it appropriate, in order for the potential benefits of the modification to be available during winter 2004/05, to grant NGC's request to waive both the 150 day and two month requirements as detailed in the Conclusion Report to the Authority.

The proposed UoSCM-M-13 will therefore be implemented on 1 November 2004 and the application fee will be implemented as of 13 September 2004.

The Authority considers that the revisions to the statement of the use of system charging methodology and the statement of the use of system charges detailed in the Conclusions Report in regard to the proposed amendment reflect the intentions of the modification proposal. Ofgem considers that NGC should revise the statement of the use of system charging methodology and the statement of the use of system charges as of 1 November 2004, consistent with the obligations in condition C4 8 of its transmission licence.

Please contact Mark Copley on 020 7901 7410 if you have any queries in relation to the issues raised in this letter.

Yours sincerely

A handwritten signature in blue ink that reads "A Walker". The signature is written in a cursive style with a large initial 'A'.

**Andrew Walker**

**Director - Transmission Networks Regulation**

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