



INITIAL THOUGHTS CONSULTATION

**Introducing a new charge for
Limited Duration TEC**

4th October 2005

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Introducing a new charge for Limited Duration TEC

Initial thoughts consultation

Executive summary

- 1 This paper sets out for consultation National Grid's initial thoughts on the charging principles that should be adopted if the Authority were to approve any of the new access products identified in CUSC Amendment Proposal CAP094. National Grid will use the comments it receives to develop its formal charging proposals.
- 2 This paper has been published on National Grid's industry website¹.

Introduction

- 3 CUSC Amendment Proposal CAP094 "Limited Duration TEC" was raised by First Hydro Company in June 2005. The amendment proposal envisaged the creation of a within-year access product that provided access up to the end of the financial year in which it was requested.
- 4 A CUSC Working Group has completed its consideration of this proposal and, in the course of its assessment, developed a number of potential alternative products. The Working Group identified six Working Group Alternative Amendments based on single products and combinations of single products. These were presented to the September CUSC Panel. The Panel agreed that CAP094 should go out to wider consultation and this has since been published and is also available on National Grid's industry website.
- 5 Each version of LDTEC, and any others that CUSC parties raise during the CUSC consultation process, will require a charging methodology to be developed and / or the existing methodology to be amended. However, until there is certainty in the access products that will go forward to the Authority for approval, National Grid does not believe it would be efficient to initiate a formal charging consultation process.
- 6 Nevertheless, in advance of this, National Grid believes it would be expeditious to conduct an informal consultation with interested parties to develop the principles upon which these methodologies could be developed.

Background

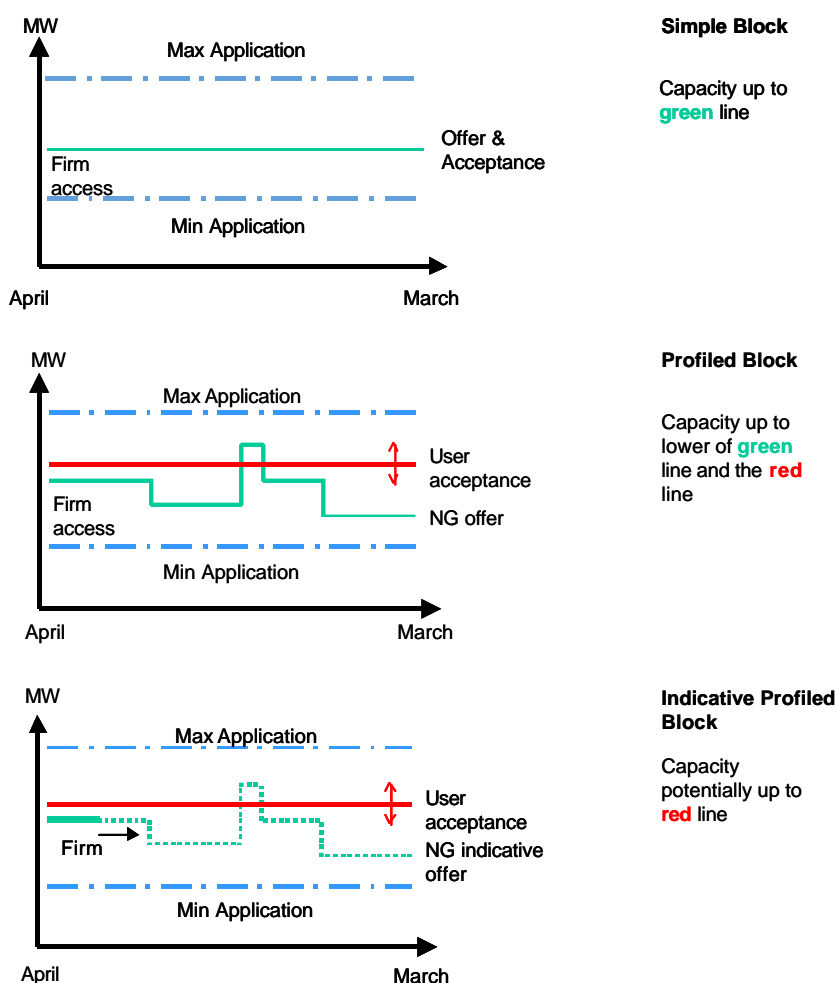
The original amendment proposal

- 7 CAP094 envisaged the creation of a short-term access product that would provide a User a uniform level of firm access from a point in time to the end of the financial year. The product had a fixed assessment, offer and acceptance timetable that would provide three weeks between a User lodging an application and obtaining access rights (if assessed to be available).

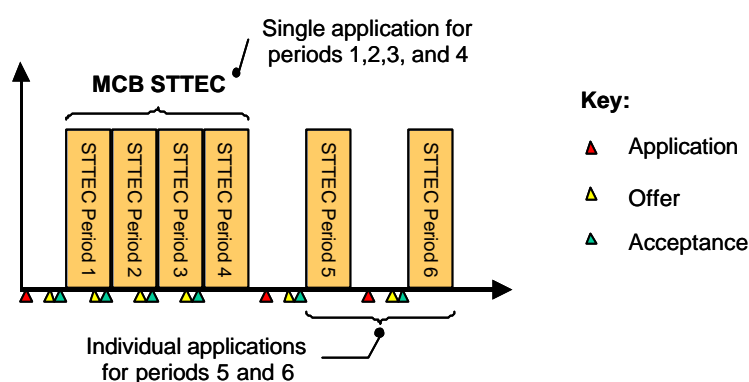
¹ See www.nationalgridinfo.co.uk/charging/index.html for National Grid's Industry information website.

Alternative LDTEC access products

- 8 In addition to assessing the original amendment proposal, the Working Group developed the following alternative forms of LDTEC:
- Simple Block (SB LDTEC)** that would provide similar access to that described in the original proposal albeit with changes to the application and assessment timetable (see below).
 - Profiled Block (PB LDTEC)** that would provide a profile of firm access profile determined by National Grid.
 - Indicative Profiled Block (IPB LDTEC)** that would provide a variable level of access, which National Grid would notify to the User on a weekly basis 8 weeks in advance of any access becoming available.
- 9 In each case, the User would specify the period of access required subject to the constraints that access could not be allowed to span more than one financial year and should be longer than six weeks. The User would also specify a capacity range (see blue lines in the diagram below). Any LDTEC offer (see green lines) would be within the capacity and date range specified. On receipt of an offer, a User would be able to accept or reject it. In the case of PB LDTEC and IPB LDTEC, the User would signal its acceptance by providing a single MW figure that would apply across the entire period (see red lines). This would define the capacity rights accepted by the User.



- 10 The time available to National Grid to assess an LDTEC application would depend on the duration of access requested. This would range from 2 weeks for access up to three months, and up to 6 weeks for access beyond 9 months. Access would then commence one week following the assessment period, if the User accepts any offer made by National Grid. Therefore, the maximum period of access that a User could obtain in a single application for LDTEC is 45 weeks (52 weeks less 6 weeks assessment and 1 week grace).
- 11 In addition to these new access products, the Working Group also considered how the existing short-term access products, STTEC and SNSTF², could be used to provide similar access. Specifically, the Working Group believed that the application process for these access products could be revised to enable Users to make a single application for **Multiple Contiguous Blocks of STTEC (MCB STTEC)** whereby each block would be assessed and offers made in accordance with the normal timescales associated with these products. This is illustrated in the following diagram.



- 12 In total this provides four single products and the Working Group has also proposed two combinations of these, PB LDTEC + IPB LDTEC and MCB STTEC + IPB LDTEC.
- 13 For further information on these products, please refer to the documentation on CAP094 that has been published on National Grid's industry information website.

Existing short-term access products

- 14 The introduction of LDTEC supplements the existing short-term access products introduced in September 2004 by CAP070, which created STTEC and SNSTF. These products provide access for four, five or six weeks at a uniform level over the period. Since being introduced, however, these products have had very limited use.

Charging Principles established for short-term access

- 15 LDTEC and STTEC share certain key characteristics. The most notable of these are that they both provide access within year and neither confer an access right the following year.

² STTEC and SNSTF are commonly referred to as STTEC. No differentiation between these products has been made in this consultation.

- 16 Given these similarities, National Grid considers it would be appropriate for the LDTEC charging arrangements to adopt a number of the charging principles that were developed for STTEC. National Grid believes these elements are:
- (a) that charges should not undermine TEC; and
 - (b) that charges should therefore be locational.
- 17 These principles were established by the Authority's decision not to veto the charging proposal for STTEC (UoSCM-M-13). In this context it is worth noting Ofgem's views on the STTEC charging proposal. In particular, Ofgem stated³:
- (a) the charging methodology would facilitate effective competition in generation by setting charges that do 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; and
 - (b) 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.

<p>Q1 National Grid would welcome views on whether or not it is appropriate to adopt the charging principles established by the introduction of STTEC for developing the charging arrangements for LDTEC.</p>
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Charges should not undermine TEC

- 18 The premium above the annual TNUoS charge for continuous use of STTEC throughout the year arises because STTEC was intended to provide access only over the peak period and the charging methodology reflected this. Specifically, for limited use up to 120 days (the period over which system peak is typically expected) STTEC would be charged at a discount to the annual product. However, where STTEC is used for longer periods, a premium charge results that could be up to 2.7 times the annual equivalent liability for TNUoS.
- 19 National Grid remains of the view that it is important that TEC is not undermined by new (and existing) short-term access products given that requests for TEC (and the associated financial commitments) are fundamental to enabling Transmission Licensees to develop an efficient, economic and co-ordinated transmission system.
- 20 However, while it is important that short-term access products do not undermine TEC, it does not automatically follow that a premium charge is needed to protect TEC as the primary access product. In particular, it is worth considering whether there are differences in the properties of TEC and

³ "Decision in relation to use of system charging methodology modification UoSCM-M-13: Introducing a new charge for short-term transmission access", 10 September 2004.

LDTEC that may either protect or undermine the primacy of TEC. A number of these are summarised in the following table.

Differences that protect TEC	Differences that undermine TEC
TEC provides a free annual option to capacity the following year whereas LDTEC does not.	LDTEC potentially provides more rapid access than TEC (assuming new infrastructure is required) since applications can be considered in shorter timescales i.e. a minimum of 3 weeks rather than 4 weeks.
LDTEC is potentially a more risky access product, as access may vary from year to year or indeed within a given year (including being withdrawn totally).	LDTEC enables Users to respond to short-term price signals that they might not otherwise been able to benefit from.
TEC provides access at a level requested by the User whereas an application for LDTEC provides access within a range, which might be somewhat less than the maximum requested.	LDTEC could provide discounted access to the transmission system for short, discrete periods of time (up a break-even point) while still enjoying the same level of firm of access.

- 21 In addition, given the current scarcity of access rights and the resulting queue for access following BETTA go-live, some of these differences may be made more acute, further increasing the degree to which TEC is protected or undermined. Against this background, National Grid expects that the majority of generators would place significant value on having an enduring access right and would therefore seek to obtain TEC in the first place and may acquire LDTEC either prior to TEC being available, in the case of new-builds, or to “top-up” any existing TEC rights.
- 22 National Grid’s initial view is that the case for a significant premium to the annual equivalent TEC charge in positive charging zones, as per STTEC, may be difficult to justify against the relevant charging objectives⁴. Specifically, the premium incurred from repeated use of STTEC arises from a charging methodology designed to reflect the intended use of STTEC i.e. to provide short periods of access over system peak. LDTEC, on the other hand, is intended to provide access periods approaching a year in duration. National Grid believes this difference could be reflected in the charging arrangements for LDTEC and therefore the basis for any premium.

Q2 National Grid would welcome views on the differences between LDTEC and TEC and how, if at all, these protect or undermine TEC as the prime transmission access product.

⁴ Standard Condition C5 of National Grid’s Transmission Licence defines the relevant objectives against which changes to the use of system charging methodology must be shown to better achieve.

Q3 National Grid would welcome comments on the level of any premium needed to protect TEC, if any, and the justification for this level.

Charges should vary locationally

- 23 Assuming that charges for LDTEC are not to undermine TEC in any charging zone, it then follows that:
- (a) charges should be derived from charges for TEC and will therefore be a multiple of TNUoS charges, which would also avoid discriminating between generators in different positive charging zones; and
 - (b) in negative charging zones it would not be appropriate to levy a positive charge for LDTEC. However a negative charge would also be unattractive since it would increase the likelihood of TEC being undermined, which could trigger reinforcements if National Grid were unable to assume the availability of the plant during system peak.
- 24 Therefore, National Grid's initial view is that in positive charging zones tariffs for LDTEC should be derived from TNUoS tariffs and in negative charging zones LDTEC tariffs should be zero.
- 25 Clearly, the approach of basing charges for short-term access on tariffs derived from long-run costs is arguably less cost reflective than a short-run cost charging model. However, National Grid believes that any reduction in cost reflectivity must be considered against broader requirements to not destabilise the charging arrangements for TEC. In particular, National Grid considers the introduction of short-run pricing for short-term access would probably call for changes to the broader transmission access arrangements.

Q4 National Grid would welcome views on whether LDTEC charges should be derived from locational TNUoS tariffs in positive charging zones and be zero in negative charging zones.

New issues for LDTEC Charging

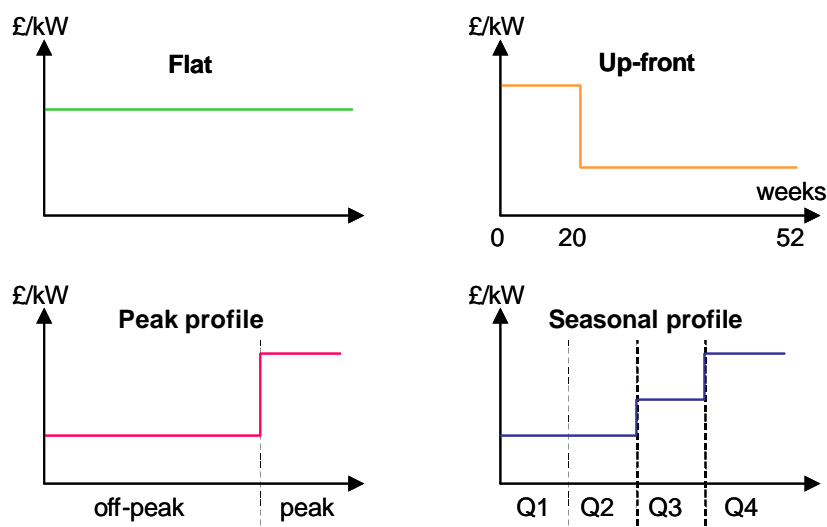
- 26 In addition to the issues described above, a number of LDTEC-specific matters need to be considered.

Temporal variation of the charge

- 27 While it may not be appropriate to levy a significant premium to the annual TEC charge where LDTEC is used throughout the year, it is for consideration whether an 'effective' premium should apply for shorter periods of use or limited use at certain times of year.
- 28 Such an approach may be necessary to ensure that the correct incentives are in place for existing generators to retain TEC and consequently prevent destabilising TNUoS tariffs for TEC.
- 29 An 'effective' premium could be achieved by having a tariff that varied depending on when LDTEC was used or the length of its use. For instance:

- (a) a higher charging rate could apply for the first x weeks of use followed by a lower rate for the remaining period (an 'up-front' approach); or
- (b) whether the product is used on or off system peak (a 'peak' approach), or a more elaborate seasonal charging structure (a 'seasonal' approach).

30 The figure below illustrates a number of temporal tariff profiles for LDTEC.



- 31 A seasonal or peak charging approach would encourage use in periods when access is cheapest, which might be expected to undermine TEC in these periods, particularly by marginal or flexible plant. However, this concern may be mitigated as network capacity is more likely to be available at these times and therefore the risk of undermining TEC will be lower since other parties tend not to require 'full' TEC during these periods.
- 32 Assuming no significant premium to TEC is applied and all other things being equal, a flat LDTEC tariff would create a charging discontinuity between access for 6 weeks (provided by STTEC) and access for 7 weeks (provided by LDTEC). National Grid does not believe there is sufficient evidence to justify changing the charging arrangements for STTEC. Therefore, National Grid's initial view is that in STTEC timescales LDTEC tariffs should tend towards those for STTEC. The 'up-front' tariff structure would provide for this while also enabling tariffs to appear more like those for TEC in longer timescales without having a significant premium charge attached. National Grid, therefore, believes there are merits in an 'up-front' approach.

- Q5** National Grid would welcome comments on the appropriateness of the various tariff profiles identified.
- Q6** National Grid would also appreciate views on how the 'up-front' approach should treat multiple applications for LDTEC in the same year.

Peak, Average or Weekly capacity-based charges

- 33 A number of the varieties of LDTEC allow a User's access rights to vary within the access period (PB LDTEC and IPB LDTEC). This variability must

be catered for in the charging methodology. A number of options are available. These are:

- (a) a **peak charge** whereby charges are driven by the maximum level of access provided and charged uniformly over the access period.
- (b) an **average charge** where the average level of access for the access period is determined and charged uniformly over the period.
- (c) a **weekly charge** where a variable charge is levied each week according to the level of access accepted (note, a User's charging liability in this approach would be equal to that in (b) above).

34 National Grid believes that charges for LDTEC should relate to the capacity rights provided to a User. For that reason, an average or weekly charge would better reflect this linkage since, with a peak-based approach, there is a risk that short peaks of access would drive charges that were not representative of the majority of the access provided (regardless of whether it is used or not). Of the remaining two approaches, an average charge has the additional benefits that it would be simpler to administer and Users would be better able to predict their charging liability.

35 Against this background, National Grid's initial thoughts are that charges for LDTEC should be driven by the average capacity accepted by the User. Nevertheless, the a peak charging approach does have the benefit of administrative simplicity and given that a User could cap its charging liability through the acceptance process (see paragraph 9 above), a peak-based charging approach may negate the necessity of an average-based approach.

Q6 National Grid seeks views on the most appropriate capacity driver for setting charges.
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Treatment of purchases of TEC and LDTEC within the same year

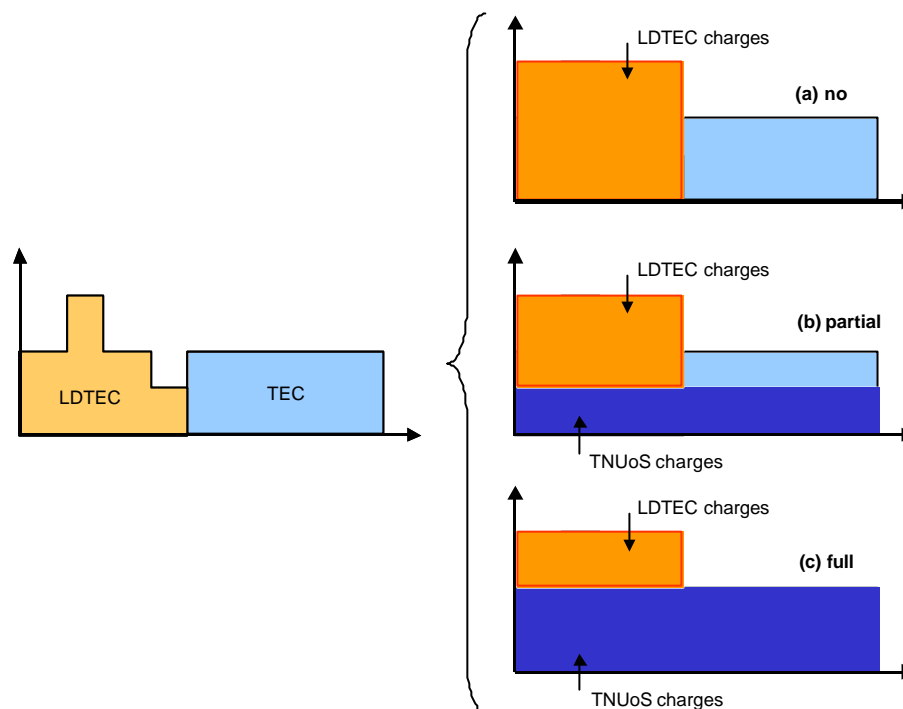
36 One of the intended uses of LDTEC is to provide system access prior to TEC becoming available. As a result, there are likely to be occasions where Users purchase LDTEC and TEC in the same financial year. In such cases, it is for consideration whether TEC has been undermined and if payments for LDTEC should affect the charges of TEC later in the year or vice versa.

37 In one respect, it could be argued that LDTEC and TEC are separate access products with different characteristics and uses that should not be linked by a charging cap referenced to TEC, as this would suggest some sort of commonality between the products that may not exist.

38 However, it could also be reasonably argued that the purchase of both products in the same year was evidence that LDTEC had not undermined TEC. Consequently, National Grid believes it is appropriate to consider the alternative means by which the charging methodology could treat the use both products in the same year, which does not cap the combined charging liability.

39 There is a spectrum of options that could be adopted. These are illustrated in the following diagrams and include taking:

- (a) **no consideration** of future TEC purchased within the year i.e. the charges for LDTEC and TEC are completely independent.
- (b) **partial consideration** of future TEC rights purchased within the year when determining the LDTEC charging liability, for example, LDTEC charges apply to only LDTEC above the highest common capacity purchased by LDTEC and TEC.
- (c) **full consideration** of future TEC rights purchased within the year when determining the LDTEC charging liability, for example, LDTEC charges only apply to that LDTEC which is above the TEC purchased.



Q7 National Grid seeks views on whether the use of TEC and an equivalent level LDTEC in the same year should be treated differently in charging methodology, as in these circumstances TEC has not been undermined by LDTEC.

Application fee for LDTEC

- 40 National Grid believes it would be appropriate levy an application fee to cover the cost of assessing each individual LDTEC application. As with the fee associated with STTEC applications, it is proposed that this should be fixed. However, the resource required to assess each LDTEC application will vary according to the length of the period of access requested; the level of access requested; whether an ongoing re-assessment is required; and whether a combined offer for PB LTEC and IPB LDTEC has been requested.
- 41 Therefore, to ensure that the application fee remains cost reflective, our initial view is that this should vary according to:

Parameter	Justification
Duration requested	Longer periods of access require more analysis to be undertaken to determine the capacity available.
Max MW requested	More extensive analysis is required for larger capacity requests, since there are a greater number of scenarios that the application must be assessed against.
Rolling confirmation (IPB LDTEC only)	Additional and ongoing work will be required for NG to reconfirm access on a weekly basis. While this might rely on existing processes, there will be an incremental cost associated with this that should be recovered.
Combined PB LDTEC and IPB LDTEC offer request	Additional resource will be required to prepare two offers for the User, which will require additional resource to prepare.

- 42 A schedule of LDTEC application fees will be included in the Statement of Use of System Charges. Due to the similarities in the process for assessing STTEC and LDTEC applications, National Grid proposes to base the level of the application fee for LDTEC on that for STTEC. Accordingly, National Grid's initial view is that the application fee should scale linearly with the assessment duration. For example, a 2-week assessment would cost £10k (for access up to 3 months) while a 6-week assessment would cost £30k (for access longer than 9 months).
- 43 National Grid also intends to levy an additional charge on these amounts of between 10% and 50% for the additional works required to assess requests for capacity amounts requested above a 500MW threshold; the rolling assessment (IPB LDTEC only); and combined PB LDTEC and IPB LDTEC offer requests. The fees may be revised once the actual costs of processing LDTEC applications become available.

Q8 National Grid seeks views on whether the drivers for the LDTEC application fee are appropriate.

Implications for MCB STTEC

- 44 MCB STTEC would, if introduced, change neither the rights associated with STTEC nor the assessment process for each STTEC period within an application. However, MCB STTEC would introduce efficiency, albeit small, in the application process for Users seeking to obtain access through contiguous blocks of STTEC since they would only need to "lick one stamp". National Grid could also benefit since it may be better able to plan for the workload associated with assessing a number of STTEC periods.
- 45 In the absence of any change to the use of system charging methodology, the default position for MCB STTEC would be derived from the existing provisions for STTEC charges.

- 46 National Grid will consider whether changes to the charging methodology for STTEC need to be progressed. National Grid notes, however, that the present drafting of the CUSC does not preclude STTEC being used throughout the year.

Views sought

- 47 Views are invited on any aspect of the issues raised in this consultation and in particular on:

- whether or not it is appropriate to adopt the charging principles established by the introduction of STTEC for developing the charging arrangements for LDTEC;
- the differences between LDTEC and TEC and how, if at all, these protect or undermine TEC as the prime transmission access product;
- the level of any premium needed to protect TEC, if any, and the justification for this level;
- whether LDTEC charges should be derived from locational TNUoS tariffs in positive charging zones and zero in negative charging zones;
- the appropriateness of the tariff profiles identified;
- how the “up-front” approach should treat multiple applications for LDTEC in the same year;
- the most appropriate capacity driver for setting charges e.g. a peak / average / weekly approach;
- whether the use of TEC and an equivalent level LDTEC in the same year should be treated differently in charging methodology, as in these circumstances TEC has not been undermined by LDTEC; and
- whether the drivers for the LDTEC application fee are appropriate.

- 48 In order that your comments and views can inform the development of National Grid’s formal charging proposals, responses must be received by **5 November 2005**. If you wish to make comments, responses are welcome by

- email to Adam.Brown@ngtuk.com; or

- by writing to:

Adam Brown
Commercial Frameworks
National Grid
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

- 49 Please clearly mark any response that should be treated on a confidential basis, the details of which will not be published.

- 50 If you have any further queries regarding this consultation, please contact Adam on 01926 655839.

Next Steps

- 51 National Grid expects to publish a formal charging consultation, as required by its Transmission Licence, following the conclusion of the CUSC consultation phase for CAP094. National Grid will use the responses to this consultation to inform the development of its final proposals for LDTEC charges.
- 52 National Grid believes there would be significant merit in aligning, to the extent possible, the timetable for initiating the formal charging consultation process with that of the Authority's decision on CAP094. This is necessary to ensure that the Authority does not veto the charging proposals because a decision on CAP094 cannot be made within 28 days of National Grid submitting its charging consultation report.