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Dear Colleague

Derogations to facilitate earlier connection of generation – proposed interim approach

National Grid Electricity Transmission plc ('NGET'), together with SP Transmission Limited ('SPTL') and Scottish Hydro-Electric Transmission Limited ('SHETL'), has recently identified scope to advance the connection dates of 450MW of Scottish renewable generation ('the 450MW') seeking connection to the transmission system and, in the case of distributed generators, to the distribution system.

The purpose of this letter is to set out the interim approach that we are "minded to" adopt for derogations from the minimum standards in the GB Security and Quality of Supply Standards ('GB SQSS'). This approach would facilitate the earlier connection of generation to the transmission system and distribution systems in GB.

We propose that the approach would apply to the 450MW of renewable generation which the transmission companies have identified as being capable of advancement. We consider that the principles that apply to our "minded to" decision on the 450MW of generation are likely to lead to the same conclusions in comparable situations where the scope to advance connection dates is limited by the need to grant a derogation from the GB SQSS. We propose this approach is adopted for an interim period until new, enduring access arrangements are introduced through the Transmission Access Review (TAR) process. We are currently working hard with NGET, the Department for Energy and Climate Change, the industry and other interested parties to deliver a new, enduring regime in the period from April 2010.

This letter explains the background to this issue, and sets out our views and the reasoning behind our "minded to" position. We would welcome comments from industry on the approach that we are "minded to" adopt and our reasoning. We are consulting for a period of four weeks. We aim to issue our final decision on this matter before 24th April 2009.

Background

Our final report on the TAR¹ noted that, in order to facilitate the earlier connection of some new generation in the period before an appropriate enduring access regime is implemented, transmission licensees would be working to identify opportunities to use derogations from minimum standards in the GB SQSS. In January 2009², we issued guidance on the information we require to inform our assessment of a derogation request to facilitate earlier connection of generation.

In February 2009 we published an open letter³ ('the February 2009 open letter'). In this open letter, we asked NGET to conduct an urgent review to consider (and if appropriate to consult on) whether urgent changes to the existing commercial and charging arrangements for access to the GB transmission system are necessary to manage more effectively the costs of constraints and to ensure that any constraint costs are recovered on an equitable basis from customers, suppliers and generators.

We set out in the annex to our February 2009 open letter some background to explain our concerns about rising constraint costs and why we consider an urgent review by NGET is necessary. In that context, we referred to the assumptions and decisions taken at the implementation of the British Electricity Trading and Transmission Arrangements ('BETTA'). We discussed the principles established for allocating transmission access rights under BETTA, which aimed to ensure that no user should be provided a later connection date or any greater access restrictions in the transition to BETTA than they had signed up to pre-BETTA. We referred to the consequential derogation issued to NGET and SPTL from the requirement to comply with the GB SQSS planning criteria over the circuits which form the boundary between England and Scotland (the Cheviot or 'B6' Boundary). This 'BETTA derogation' remains in force until 2011/12, subject to continuous review and a range of conditions. We noted that the decisions taken at the time of BETTA were taken in light of forecasts provided by NGET and consulted upon extensively with the industry about the anticipated levels of constraints costs associated with the derogations. We set out our view that recent observed levels of constraints costs and NGET's forecast of constraint costs for next year, which were significantly higher than the forecasts at the time of the implementation of BETTA, implied the need to revisit these assumptions. GB constraint costs have, for example, risen from around £84m per annum in 2005/6 to a forecast of £238m for 2008/9; NGET's current forecast is that these costs will rise to £258m⁴ in 2009/10.

In our February 2009 open letter we also noted that NGET has recently identified scope to advance the connection dates of 450MW of Scottish renewable generation (both transmission-connected and distributed generation) based on the transmission and distribution network owners' abilities to advance the local transmission and distribution connection work as well as generators' own willingness and ability to utilise earlier connection. We advised that we would need to understand the actions that NGET proposes to take to manage any associated additional constraint costs and that this will form an important input to our ongoing work to assess the merit of advancing the connection of these generators. We also recognised the benefits, in terms of reductions in carbon emissions, from the earlier connection of renewable generation.

In response to the issues discussed in the February 2009 open letter, NGET has now brought forward two urgent proposals:

¹http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/080626_TAR%20Final%20Report_FI_NAL.pdf

²<http://www.ofgem.gov.uk/Networks/Techn/TechStandds/Derogtns/Documents1/Derogationconclusion.pdf>

³<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/20090217Managing%20constraints.pdf>

⁴ This forecast of £258m is taken from NGET's System Operator Incentives Final report, published on 27 February 2009.

- A charging modification which proposes introducing a locational element to Balancing Services Use of System (BSUoS) charges. This aims to target the costs of resolving constraints onto the generators, behind constrained boundaries, who trigger constraint actions.
- CUSC Amendment Proposal (CAP 170): Category 5 System-to-Generator Operational Inter-tripping Scheme. This proposes introducing a new category of inter-trip⁵, with administered prices, for generators located behind a non-compliant transmission boundary. If implemented, the effect of CAP170 would be to reduce the significant costs of constraints borne by (unconstrained) generators, suppliers, customers and to a lesser extent NGET (through its incentive scheme).

These proposals are being progressed through the industry process.

Proposed Approach to interim GB SQSS derogations

We consider it is appropriate that NGET, SPTL and SHETL continue to consider the scope to advance connection dates including, where appropriate, through GB SQSS derogation until more enduring access reform are in place⁶.

In our revised derogation guidance we set out that Ofgem's assessment of derogation requests would take into account the Authority's statutory duties and would consider appropriate costs (primarily constraint costs) and benefits including the benefits of reduced carbon emissions.

Whilst we will consider each application on its merits by reference to our revised derogations guidance and the matters set out in the letter (of 19 January 2009) which accompanied the publication of the derogation guidance, particularly Appendix 1, we consider that this analysis may not be pivotal to our decision on whether to grant the derogation in the context of the 450MW and other generators seeking a connection in comparable circumstances.

The practical effect of the 'BETTA derogation' is that transmission capacity is effectively "oversold" in Scotland. The total amount of rights to the access the system which have been sold to generators exceeds the current physical capacity of the transmission system, in particular at the Cheviot boundary. This clearly benefits those generators in Scotland that have access to these rights as they are able to sell their output or receive compensation (through constraint payments) if they are unable to generate because there is insufficient transmission capacity.

In deciding whether to maintain (or extend) the BETTA derogation we need to be mindful of our statutory duties and other relevant objectives, including: the impact on customers, including through the effect on constraints costs; the impact on competition in generation; the impact on sustainability; and the impact on security of supply. There are also important statutory requirements driven by European legislation⁷ and domestic legislation that requires us to be satisfied that grid access arrangements do not discriminate unduly between different transmission users.

⁵ "Inter-trip" services are an automatic control arrangement to reduce or temporarily disconnect generation or demand following a fault event on the GB transmission system. When an inter-trip arrangement is in place, additional power may be flowed over the relevant transmission lines without breaching the GB SQSS, since if a selected circuit trips the generation or demand in question will automatically be disconnected to avoid the lines overloading. Inter-trip services along the derogated Cheviot (Anglo-Scottish) boundary are currently negotiated on a bilateral commercial basis between NG and relevant generators, and are very expensive relative to comparable arrangements in England & Wales. Bringing these commercial arrangements into the CUSC under administered prices could result in significant savings to NG in relation to managing Cheviot constraints.

⁶ The transmission licensees are currently undertaking a fundamental review of the GBSQSS, which may result in changes to the GB SQSS to apply under the enduring access arrangements. Therefore any derogations issued to facilitate earlier connection of generations would be against the current GBSQSS for the interim period.

⁷ Electricity Directive 2003/54/EC

At present, the industry is engaged in a programme of reforms which are expected to result in a new, enduring transmission access regime. The proposed modifications to the transmission access arrangements include measures which, if implemented, are likely to remove the need for the 'BETTA derogation'.

Whilst the 'BETTA derogation' remains in place, it is appropriate to consider whether, and if so on what basis, other generators seeking to connect to the transmission and distribution systems should be able to benefit from a derogation which currently enables certain generators to access to the system in advance of the reinforcements that are necessary to ensure compliance with the GB SQSS.

Generators were able to benefit from the 'BETTA derogation' if they had agreements with, or had applied to connect to, a transmission system or distribution system in GB on or before 1 January 2005. This decision was supported at the time by NGET and the Scottish transmission companies' analysis. But the practical effect of that decision is that generators who were connected to the system prior to that date, or had made an application to connect before that date, enjoy substantial benefits through being able to access the system compared with generators who have sought connection since that date.

We do not think that there is any objective justification for this apparently differential treatment of generators which is based solely on criteria which are linked to a point in time. Generators who were already connected to the system prior to this date did not, in our view, have any defined long term rights. This is because they retain the option to surrender their access rights and stop paying access charges at short notice - the current commercial arrangements do not impose any long-term obligation to pay for access to the grid. As an example, at the implementation of BETTA in 2005, Hunterston had a TEC of 1210MW. This TEC was subsequently reduced in 2008 to 1089MW.

We consider it is important that any decisions about further derogations against GB SQSS which would have the effect of allowing further over-selling do not result in undue discrimination between existing connected generators (or those who had signed a connection agreement or applied to connect before 1 January 2005) and generators who have sought a transmission or distribution connection since that date. In our view, whilst the 'BETTA derogation' remains in place, if we are to avoid undue discrimination, we would need to **extend the principle of over-selling**. In other words we would need to permit transmission capacity to be oversold to other generators in comparable situations seeking to connect to the transmission and distribution systems across GB to avoid any undue discrimination. For the avoidance of doubt, we consider that generators in comparable situations are those generators whose connection date is delayed as a result of the need to complete reinforcement to the wider transmission system, but not as a result of local connection works being incomplete-or as a result of there being no physical connection to the contiguous GB transmission system.

Extending the principle of over-selling would have the benefit of allowing the 450MW of renewable generators to advance in the queue. This will accelerate the reduction in carbon dioxide emissions which will result from the deployment of renewable generation. The downside from extending the principle is that it might give rise to higher constraints costs at a time when constraints costs have risen sharply.

But we think that the issue of how best to manage and recover the costs of constraints equitably from customers, suppliers and generators is separate and distinct from the question of whether the derogation should be extended to allow generators seeking connection (including the 450MW of generation) to connect to the system. This is because it is now clear that the original decision to grant the derogation at the time of BETTA has in itself given rise to significant constraints costs. We are satisfied that the issue of constraints costs is now being properly considered and debated by the industry through the normal industry processes associated with NGET's two modification proposals.

We also note that the incremental costs of extending the principle of over-selling capacity are likely to be relatively modest for the following reasons:

- First, decisions on the derogations from the GB SQSS would be made in the context of the ongoing reform of the transmission access arrangements. If the Authority decides in favour of one or more of the proposals to amend the current arrangements, these reforms are expected to result in changes to the access arrangements from April 2010. Thus, our derogation decision would only impact on constraints costs for a limited period of time.
- Second, we understand from NGET that, whilst the impact of the 450MW on constraints costs might amount to as much as £40 million per annum, costs would build up to this level and might be significantly lower than this figure in the first year of the derogation. In the absence of any abuse of market power, the connection of renewable generation in Scotland, with a very low marginal cost of generation, will only give rise to higher constraints costs if they displace generation in England and Wales rather than Scottish generation units (which will depend on the relative efficiency of existing, non-renewable generation)
- Third, the impact on constraints costs will depend on the actions to manage such costs that NGET takes as GB system operator. We note that, following our February 2009 open letter, NGET is reviewing the existing arrangements for managing constraints costs. We welcome the fact that NGET has brought forward for consideration proposals that aim to manage constraints costs more effectively, and consider that the industry governance process will provide an appropriate forum to consider the issue thoroughly and transparently.

We are therefore "minded to" extend the principle of over-selling for an interim period until, and subject to, the timely and successful implementation of enduring access arrangements.

Way forward

We invite industry comments on the position that we are "minded to" grant derogations, and our analysis and arguments to support this position. This "minded to" decision will enable NGET to facilitate the earlier connection of generation to the transmission and distribution systems, where NGET has identified generation as potentially being able to connect in advance of the reinforcements required to ensure compliance with the current GB SQSS. This includes the 450MW of renewable generation NGET has already identified as being capable of advancement in Scotland.

For the avoidance of doubt, we therefore expect that in advance of the new, enduring access arrangements being introduced, NGET will offer, on a non-discriminatory basis, to advance the connection dates of those generators seeking connection to the transmission or distribution systems⁸ in GB. We anticipate that NGET should be able to advance connection dates where the generators connection date is delayed by the need to complete reinforcement to the wider transmission system, but not as a result of local connection works being incomplete, or as a result of there being no physical connection to the contiguous GB transmission system.

It is intended that this approach is adopted in the interim period until the new, enduring access arrangements are in place. This approach is intended to be a pragmatic and feasible solution before the enduring transmission access reforms are implemented. It does not have any implications for the decisions the Authority will take in respect of proposals for the enduring access arrangements. Whilst we have every confidence in the TAR process and timetable, respondents should note that we cannot rule out the need to revisit this approach and the principle of overselling in general if, for example, there was a significant

⁸ Notwithstanding any extension of the principle of over-selling, Ofgem expects that all distribution network operators will continue to advise National Grid, in line with their Connection and Use of System Code obligations, of any connection applications by distributed generation which may have transmission system constraints implications.

delay to TAR or other unforeseen developments. In such circumstances, we would be mindful of the need to avoid undue discrimination and would need to consider the issue of overselling in general. This would require remedies which would affect all generators in areas of over-selling, rather than solely focusing on generators who have connected or plan to connect to the transmission or distribution networks from a particular point of time.

We recognise that our "minded to" decision may increase the level of constraints costs. However, the impact on costs may be small in the short term and additional mechanisms may become available to the System Operator to manage these costs. Nevertheless we will keep constraint costs and any derogation under review and if costs were to rise for any reason, we would expect NGET to consider whether further changes to the commercial and charging arrangements for access to the GB transmission system are necessary.

We would welcome views on the proposed approach set out above. We will consider all responses in reaching a final view. Please send responses to Lesley.nugent@ofgem.gov.uk by 16th April 2009.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Stuart Cook', is written over a horizontal line.

Stuart Cook
Director, Transmission