

To generators, shippers, suppliers, network companies, consumers and their representatives, the sustainable development community, and other interested parties.

Promoting choice and value for all gas and electricity customers

Reference Number: 119/10
Email: Project.TransmiT@ofgem.gov.uk

Date: 22 September 2010

Dear colleague

Project TransmiT: A Call for Evidence

Project TransmiT is Ofgem's independent and open review of transmission charging and associated connection arrangements. We are keen to ensure that our review draws on the widest range of stakeholder views and evidence. This open letter is the first step in this process. It invites views on the scope of and priorities for the review and calls for evidence from generators, shippers, suppliers, network companies, consumers and their representatives, the sustainable development community, and other interested parties.

We welcome responses to this call for evidence by **Wednesday 17 November 2010**.

Context

Britain is facing an unprecedented challenge driven by the need to connect large amounts of new and low-carbon generation to the electricity networks to meet climate change targets, while continuing to ensure value for money for consumers and security of supply. As a result, electricity and gas networks are going through radical change.

The current transmission charging regime has served consumers well by promoting the efficient use of the networks, and facilitating effective competition in generation and supply. However, the time is right for us to step back and consider whether the arrangements are fit to meet the challenges of the future. In particular, Parliament recently clarified Ofgem's duties including our duty to have regard to the need to contribute to sustainable development. And, following the implementation of proposals to change the way the industry is governed¹, industry parties and Ofgem will have the ability to instigate changes to the charging arrangements.

Objectives

The aim of the review is to ensure that we have in place arrangements that facilitate the timely move to a low carbon energy sector whilst continuing to provide safe, secure, high quality network services at value for money to existing and future consumers.

¹ In March 2010, we issued our final proposals following the Code Governance Review. These are available at <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=297&refer=LICENSING/INDCODES/CGR>

Scope

The review incorporates both the electricity and gas transmission arrangements, and will consider charging, related connection issues and the way in which charging will need to accommodate cross-European and other market and regulatory developments. We recognise that the scope is wide, but we believe this is necessary given the interactions between the gas and electricity markets and carbon capture and storage (CCS), as well as between charging and connection. We are also mindful of the wider policy context of the energy regulation debate, particularly the increased physical interconnection with European system and the requirement to integrate more closely the wholesale markets, and the potential for change to the fundamental market design and charging principles.

Following consideration of the responses to this call for evidence, we will look to prioritise those areas of the current regime that require most urgent attention.

Government has recently implemented enduring reforms to the electricity transmission grid access arrangements². Project TransmiT will focus on aspects of the current arrangements that fall outside the scope of the Government's work and have been specifically left to us to resolve with industry. Project TransmiT will have a particular focus on the transmission charging arrangements and the practical and commercial difficulties experienced by parties seeking to connect to and use the transmission networks.

The existing charging regime

As system operator, National Grid Electricity Transmission plc (NGET) and National Grid Gas plc (NGG) are obliged under their licences to establish and keep under review appropriate transmission charging methodologies for the electricity and gas transmission system³. The current licence obligations require these two licensees to have in place charging methodologies that, amongst other things, facilitate effective competition in the generation and supply of electricity and between gas shippers and between gas suppliers, and which result in charges that, as far as is reasonably practicable, reflect the costs that have been incurred by licensees.

The principle of cost-reflectivity is based on the economic rationale that, in general, competition is more likely to be effective if costs which parties impose on the system are reflected in the charges they pay and thus are appropriately factored into their commercial decisions. This in turn ensures that the cost of delivery of the required transmission infrastructure is not higher than it needs to be. It is these costs which are ultimately borne by consumers.

Cost-reflectivity is used as the basis for the current methodology applied by NGET and NGG to calculate charges for using the respective electricity and gas transmission networks.

The electricity transmission charges consist of⁴:

- **Connection charges:** These are designed to recover the costs for the provision and maintenance of assets which are solely required to connect a particular user to the transmission network, and are derived from asset-specific costs;

² <http://www.decc.gov.uk/assets/decc/Consultations/Improving%20Grid%20Access/251-govt-response-grid-access.pdf>

³ These are set out in the standard licence condition SLC C5 for NGET and the standard special licence condition A5 for NGG.

⁴ Further details on the existing charging regime are available at NGET's website: <http://www.nationalgrid.com/uk/Electricity/Charges/>

- **Transmission Network Use of System (TNUoS) charges:** These are designed to recover the costs of providing and maintaining the wider infrastructure assets, and are derived by modelling a user's impact on the long-run average costs; and
- **Balancing Services Use of System (BSUoS) charges:** These are designed to recover the costs incurred by the System Operator for keeping the electricity system in balance in operational timescale (such as resolving constraints) and are currently applied on a uniform tariff basis.

Under the current gas charging arrangements, NGG recovers the costs of getting gas onto the network (the entry portion of its allowed revenue) through entry capacity auctions and the Transmission Owner commodity charge. The latter consists of the difference between the entry portion of its allowed revenue and the revenue received from the capacity auctions, and is levied on actual flows of gas. In contrast, the costs of taking gas off the network (exit revenue) are recovered from an administered charge, although exit commodity charges are due to be introduced with the enduring exit regime⁵.

We are mindful that the future may see the growth in transportation arrangements for CO₂ on the back of the development of carbon capture and storage solutions. We will, therefore, need to consider the way in which charging arrangements for electricity and gas might need to be reflected in the charging arrangement for the transportation of CO₂.

Existing connection arrangements

The arrangements for connection to the electricity transmission network are governed by the Connection and Use of System Code (CUSC)⁶. Under the grid access model being implemented by Government, a new generator or demand user seeking to connect to and use the transmission system will be able to gain full access to the transmission system once all the "enabling works" are completed. Before the commencement of the full access, the user is required to put in place financial security⁷ to safeguard against the risk of stranded transmission investment in the event of the user terminating the connection process. The process relating to enabling works is still based on first-come-first-served principle, and the completion date of enabling works continues to be fully subject to the transmission investment timescale. Government's grid access reform does not extend into much of the connection process. Instead, it has left Ofgem and industry to consider further and resolve any outstanding issues.

The arrangements for users of the gas national transmission system (NTS) to procure new ("incremental") capacity are detailed in the relevant methodologies⁸. There are associated obligations within NGG's gas transporter licence to ensure the timely provision of associated reinforcement of the NTS. The arrangements for connecting to the NTS are usually based on bilateral negotiation between NGG and the associated developer/shipper. There are ongoing meetings between NGG and the industry to improve the transparency and reliability of this connection process.

Please refer to the technical annex of this letter⁹ for further information on the existing charging and connection arrangements.

⁵ Further details of current arrangements are available at <http://www.nationalgrid.com/uk/Gas/Charges/>

⁶ <http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/>

⁷ There are currently two alternative arrangements by NGET: Final Sums as the default arrangement and the user can choose the alternative Interim Generic User Commitment Methodology. More details on NGET's website: <http://www.nationalgrid.com/uk/Electricity/GettingConnected/PoliciesAndGuidance/>.

⁸ The Incremental Entry Capacity Release methodology and Exit Capacity Release methodology

⁹ http://www.ofgem.gov.uk/Networks/Trans/PT/Documents1/Project_Transmit_A_Call_for_Evidence_Technical_Annex.pdf

Call for evidence

We are seeking views on whether the existing charging and connection arrangements for electricity and gas transmission facilitate the achievement of our objective, i.e. to facilitate the timely move to a low carbon energy sector whilst continuing to provide safe, secure, high quality network services at value for money to existing and future consumers. Where possible, we ask respondents to evidence their views with objective analysis and examples.

We do not want to be prescriptive in terms of the detailed issues that we would like stakeholders to consider and welcome responses on any aspect of regulation related to the scope of Project TransmiT. However, some examples of the types of evidence and views we are looking for are provided below.

Charging

For example, in relation to **charging**, we would welcome relevant evidence and views on:

- Whether our objectives for Project TransmiT are appropriate;
- Whether the principles on which the current charges are derived remain fit for purpose given the new and emerging challenges that the energy sector faces. If not, evidence of why this is the case and suggestion of what alternative or additional principles should be adopted;
- Whether NGET's and NGG's approach is consistent with the principles currently in place, and whether their approach is applied consistently;
- Whether the current arrangements deliver value for money to energy consumers;
- Whether the current arrangements facilitate appropriately the connection of low carbon generation including renewables and any other new generation, preferably with evidence of impacts of transmission charges on such generation (note that this, as well as all other parts of a response, can be provided on a confidential basis); and
- Whether there are particular issues associated with transmission charging that should be prioritised.

Connection arrangements

For example, in relation to **connection arrangements**, we would welcome relevant evidence and views on:

- Whether our objectives for Project TransmiT are appropriate;
- Whether there are practical problems hampering connection to the network. If so, we would welcome evidence of the problems and suggestions for resolution;
- Whether the current arrangements ensure fair treatment of system users; and
- Whether there are particular issues associated with connection arrangements that should be prioritised.

Process for progressing any changes to the existing regime

The new governance arrangements introduce the 'Significant Code Review' (SCR) process, under which Ofgem will play a leading role in facilitating code changes. SCRs will provide a holistic approach to developing and making code changes in areas of complex reform of a technical nature. We noted in our August 2010 open letter consultation on SCRs¹⁰ that we

¹⁰http://www.ofgem.gov.uk/LICENSING/INDCODES/CGR/Documents1/SCR%20open%20letter%20consultation_Aug10_final.pdf

are currently considering whether the transmission charging arrangements need to be reviewed through a SCR. We will need to consult on whether an issue should be addressed through this route before launching an SCR and therefore welcome views on this in responses to this call for evidence.

Engaging in Project TransmiT

We are committed to conducting a transparent and open review.

As well as consulting thoroughly with stakeholders, we are planning to hold roundtable events and industry workshops. We currently plan to hold the first event in October this year and will publish details shortly. We anticipate that such events will provide interested parties with an opportunity to consider:

- the current transmission charging regime and its relative strengths and weaknesses;
- the alternative charging models available and examples of international perspective/experience; and
- interactions between the transmission charging regime and the wider context.

Following on from the success on our recent RPI-X@20 web forum¹¹, we will provide a dedicated web forum for Project TransmiT, which will be available to all interested parties. The web forum provides stakeholders with an opportunity to contribute to Project TransmiT by providing us (and other interested parties) with analysis and papers that can be posted on the Ofgem website, thus contributing to the body of evidence and stimulating debate.

The project team will also upload working papers for discussion – as well as relevant responses. If you have a paper or document you would like to have posted here, please email Project.TransmiT@ofgem.gov.uk. We intend to adopt similar criteria on posting papers as those for the RPI-X@20, namely, they must be relevant, constructive, attributable to defined party, not include any inflammatory or disparaging references to any stakeholder, and be submitted through email within defined timelines.

We will also be commissioning independent reports from external academic advisors. We have initiated work to appoint these advisors, and will issue more detail, including on the terms of reference for the independent reports, in the near future.

Timetable

The proposed high-level timetable is set out below. As well as publishing formal consultation documents, we will seek to engage with interested parties throughout the review, for example through workshops and the web forum. This timetable is our initial plan and it may change as issues are raised through further work and consultation. We will ensure that any changes are properly communicated to stakeholders.

17 November 2010	Deadline for responses to this call for evidence
October 2010	First stakeholder events
December 2010	Publish responses to call for evidence
March 2011	Publication of the independent academic reports
Spring 2011	Consult on options identified in light of evidence gathered
Summer 2011	Publish our recommendations

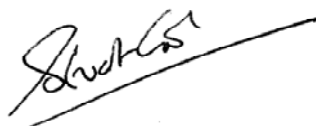
¹¹ The RPI-X@20 web forum is available at <http://www.ofgem.gov.uk/Networks/rpix20/Pages/RPIX20.aspx>

Next steps

We welcome responses to this call for evidence by **Wednesday 17 November 2010**. All responses will be placed on our website unless marked as confidential. Please email your response to Project.TransmiT@ofgem.gov.uk.

Please contact Anthony Mungall (anthony.mungall@ofgem.gov.uk) or Lesley Nugent (lesley.nugent@ofgem.gov.uk) should you require any more information on the issues discussed in this call for evidence.

Yours sincerely

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

Stuart Cook
Senior Partner, Smarter Grids and Governance