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Dear Colleague,

Transmission Arrangements for Distributed Generation ("TADG") Working Group: Invitation and draft terms of reference

Ofgem has recently consulted on and held a number of seminars to discuss the appropriate form of enduring transmission arrangements for distributed generation. Ofgem retains the view that it should be for licensees, in tandem with the industry, to develop any proposals for changing the existing arrangements. As a first stage in this process and having considered the views expressed by respondents, we propose to establish a working group to be tasked with developing specific options for change.

This letter sets out the purpose of the working group, and seeks applications from industry members wishing to be involved.

The working group

We envisage that the TADG working group will meet on approximately a monthly basis from the week commencing 10 July 2006. In the first instance Ofgem envisages the need for six meetings¹. However, as the working group was convened in response to calls from industry participants, we would expect working group members to play a proactive role in contributing to the Group and determining its scope of work. In order to minimise the burden on group members, where possible we intend to schedule meetings at times and locations which are linked to other industry fora - such as the Charging Implementation Steering Group or the Transmission Charging Methodology Forum.

The working group will primarily be charged with developing "straw-men" for the form of enduring transmission arrangements for distributed generation, building on the findings of the consultation process to date. The key focus of the working group will be on the issues which would be encountered in implementing one of the options supported by respondents to Ofgem's discussion document. All material generated by the group will be published on a designated section of the Ofgem website. The first meeting will be on 12 July 2006 at Ofgem's London offices. This meeting will be chaired by Ofgem. One of the

¹ Further detail on the envisaged content of these meetings is set out in the attached Terms of Reference.

issues for the first meeting, given this is intended to be an industry group, will be to determine appropriate chairing arrangements for subsequent meetings.

If you are interested in attending the group, please contact Cheryl Mundie (cheryl.mundie@ofgem.gov.uk, 0141 331 6003) by 30 June. Attendance is limited to one person per relevant industry party.

Background

In approving National Grid Electricity Transmission plc's ("NGET") proposed GB transmission charging arrangements in March 2005, the Gas and Electricity Markets Authority ("the Authority") recognised that there would be merit in NGET further reviewing the appropriateness of its current charging arrangements to accommodate the increasing demand for transmission capacity from distributed generation. As a first stage in this process we announced our intention to undertake a consultation setting out the key issues and a discussion of possible options.

In September 2005 we published a discussion document² outlining a number of key issues arising from the existing charging and contractual arrangements and highlighted a range of potential options for addressing these issues. The purpose of the document was not to draw firm conclusions or prescribe a specific way forward but to facilitate debate and encourage parties to consider the extent to which changes to existing arrangements could be expected to result in benefits to competition. These views were explored further in two industry workshops hosted by Ofgem in Glasgow on 19 January and in London on 24 January 2006.

On 31 May 2006 we published a further thoughts document³. This summarised respondents' views and sought to focus debate on the future direction of the development of the existing charging and contractual arrangements.

One of the key views that emerged out of the consultation process was the complexity of the issues to be addressed and the fact that those issues potentially cut across a number of different industry codes and documents. Respondents argued this would mean that the governance and consultation processes for any of the individual codes or documents would be insufficient to develop a holistic solution to the existing problems. On this basis it was considered that Ofgem needed to have a central role in the process.

Proposed approach

Ofgem retains the view that it should be for licensees, in tandem with the industry, to develop any proposals. It would be inappropriate for Ofgem to be centrally involved in prescribing particular solutions given our decision making role in any proposed modifications to existing arrangements. However, at the same time Ofgem accepts that we can play a constructive role in co-ordinating and facilitating the development of possible options. On this basis we set out our conclusion in the May paper that the best way of fulfilling this role is to establish a development group tasked with developing straw-men for the form of enduring transmission arrangements for distributed generation.

² Enduring transmission charging arrangements for distributed generation – a discussion document – September 2005, Ofgem #211/05

³ Enduring transmission arrangements for distributed generation – further thoughts document – 31 May 2006, Ofgem #92/06

We consider that the role and operation of the group will be similar to that of the Access Reform Options Development Group ("ARODG"). The ARODG was established in March 2006 as part of the Transmission Price Control Review and tasked with supporting the development of potential options for changes to the way in which capacity on the GB transmission system is allocated.

Like the ARODG, the TADG working group will be clearly focussed on developing straw-men models which are considered to be both achievable in the medium term and capable of addressing the identified areas of concern with the current arrangements – focussing particularly on the issues associated with implementing any of these models. The group will be tasked with building on the work of the consultation process to date by considering in more detail those options identified by respondents as having the most potential to deliver a robust enduring framework, namely the agency models.

Terms of Reference

The draft terms of reference for the TADG working group are attached to this letter, and will be discussed at the first meeting of the group. In line with the ARODG we would like to stress that the group is intended to be a helpful pre-cursor to (and not a substitute for) parties considering whether they wish to raise specific modification proposals. The establishment of this group does not affect, in any way, Ofgem's formal decision-making role under relevant code or document modification processes.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Robert Hull', with a horizontal line underneath.

Robert Hull
Director of Transmission

Draft terms of reference

Transmission Arrangements for Distributed Generation (“TADG”) Working Group

Group composition

Chair: Ofgem (first meeting); subsequent meetings - TBC

Objectives of TADG

The purpose of the group is to seek to identify options for change to the transmission arrangements as they affect distributed generation in the light of the following criteria:

- ◆ **Minimising implementation costs.** The arrangements should not impose undue implementation or administrative costs on industry participants, recognising that such costs might be expected ultimately to be passed on to consumers.
- ◆ **Cost reflectivity.** The arrangements should seek to reflect the costs that industry participants impose on the system. Cost reflective charges promote effective competition between industry participants and facilitate market entry.
- ◆ **Efficient network development.** Arrangements should encourage efficient decisions can be taken regarding the development and use of the transmission and distribution networks.

Scope

The scope of the matters for consideration by the working group is confined to those relating to the appropriate development of transmission arrangements to reflect the impact of distributed generation on the transmission network.

In light of respondents’ comments to the recent consultation process, there are four key issues that are within the scope of the working group. These are:

- ◆ the development of appropriate charging arrangements that ensure parties pay charges which reflect the costs they impose on the networks and which thereby remove the scope for perverse incentives when deciding where, and at which voltage, to connect;
- ◆ the interaction with issues of transmission access including the treatment of exporting Grid Supply Points without access rights to the GB transmission system, the nature of access rights appropriate to distributed generation and any interactions with the work of the Access Reform Options Development Group;
- ◆ the impact of distributed generation, as compared to transmission connected generation, on the operation and planning of the GB transmission system and what that implies for system planning and operational control, including issues around the need for direct interfaces between distributed generators and the system operator; and
- ◆ the ease of implementation and implementation costs associated with any solution.

Given that the consultation process to date has already considered these issues in the context of a number of potential options, the working group will build on this work and primarily focus on developing in more detail the options identified through that process as having the most potential to deliver a robust enduring framework, namely the agency models.

It is anticipated that the working group format will facilitate and co-ordinate industry discussion of these options and the above issues in a holistic manner. This should lead to the development of straw-men models and the identification of changes to the industry codes, licences or other documents, the combination of which would be necessary to deliver those models. It will then be for the industry to consider whether to take forward any of the straw-men and if so to submit change proposals to the industry codes.

In developing these options, key questions for the group to consider are:

- ◆ to what extent is the impact (flows, operation, planning, investment and associated costs) of distributed generation on the GB transmission system the same as that of transmission connected generation;
- ◆ are the existing transmission access products appropriate to distributed generators, is there merit in considering access products based on the export to the GB transmission system rather than the full capacity of the generator; and
- ◆ if a distributed generator does not have firm transmission access rights then how can its export to the GB transmission system be controlled? Can this be achieved through the Distribution Network Operator or the supplier?

It is important to note that the group is a development group and not a decision making body. In particular, nothing presented or discussed at the group can have the effect of fettering the Authority's discretion in relation to any decisions it takes on any forthcoming relevant industry code modification proposals.

Organisation of meetings

The first meeting of the working group will be on 12 July 2006 at Ofgem's London offices. This meeting will be tasked with clarifying the objectives of the group and with identifying the range of agency arrangements which would be subject to further development. In particular, Ofgem considers that the Distribution Network Operator and supplier agency models and any other hybrid model or variation of the two merit further review and we consider that subsequent meetings should be subdivided to consider different aspects of both of these models.

Meeting 2 will focus on issues of developing appropriate charging arrangements which reflect the impact distributed generators have on the transmission network.

Meeting 3 will focus on the interaction with issues of transmission access including the treatment of exporting GSPs without access rights to the GB transmission system.

Meeting 4 will seek to consider wider issues of system planning and operational control.

Meeting 5 will consider implementation issues including code modification changes and costs.

Finally, meeting 6 will seek to refine any models and to test these against the key objectives for the group.

Where possible Ofgem will seek to ensure that all meetings convene at a time and location linked to other industry fora such as the Charging Implementation Steering Group or the Transmission Charging Methodology Forum.

Deliverables

1. Develop the detail of a range of agency models identifying associated changes to transmission arrangements for distributed generation

Work is expected to include:

- ◆ detailing the changes necessary, and issues associated with implementing, the options supported by respondents to Ofgem's discussion document;
- ◆ clarifying the need for change to industry codes and other related documentation; and
- ◆ identifying the future benefits and costs of any option being progressed via existing change processes.

2. Publication of group findings

Detail of the working group's discussions, straw-men and findings will be made public via a designated section of Ofgem's website.