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Direct Dial: 020 7901 7009
Email: stuart.cook@ofgem.gov.uk

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Dear Colleague

Derogations to facilitate earlier connection of generation – decision on interim approach

We published an open letter on 19 March 2009¹ ('the March 2009 open letter') setting out and consulting upon the interim approach that Ofgem is 'minded to' adopt for derogations from the minimum standards in the GB Security and Quality of Supply Standards ('GB SQSS'). This approach will accelerate the connection of new (predominantly renewable) generation to the transmission system and distribution systems in Great Britain, ahead of more fundamental and enduring reform of the arrangements for connecting to and using the electricity transmission system.

This letter summarises the responses we have received to the March 2009 open letter and sets out our views on the issues raised by respondents. It also sets out our decision to adopt, for an interim period until, and subject to, the timely and successful implementation of new, enduring access arrangements, the approach we set out in the March 2009 open letter.

Background

We set out in the March 2009 open letter the background to this issue, including the following:

- **Use of derogations to facilitate earlier connection:** the Transmission Access Review ('TAR') Final Report² said that transmission licensees should work to identify opportunities to use derogations from the GB SQSS to allow earlier grid connections in the period before an appropriate enduring access regime is implemented. In January 2009³, we issued guidance on the information we require to inform our assessment of a derogation request to facilitate earlier connection of generation.
- **Constraints management issues:** we noted that in February 2009 we published an open letter⁴ ('the February 2009 open letter') on managing constraints. In this open letter, we asked National Grid Electricity Transmission plc ('NGET') to conduct

¹<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/Derogation%20letter%2019%20March%202009.pdf>

²http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/080626_TAR%20Final%20Report_FINAL.pdf

³<http://www.ofgem.gov.uk/Networks/Techn/TechStandds/Derogtns/Documents1/Derogationconclusion.pdf>

⁴<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/tar/Documents1/20090217Managing%20constraints.pdf>

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 noted in the March 2009 open letter that NGET has now brought forward proposals that aim to address the issues discussed in the February 2009 open letter.

- **BETTA⁵ derogation:** we explained the background to the BETTA decision to grant a derogation to NGET and SP Transmission Limited 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). We noted that the effect of that decision is to permit the **overselling** of transmission capacity in Scotland to certain generators that had connected or applied to connect to a transmission or distribution system in GB by 1 January 2005.
- **'The 450MW':** finally, we noted that NGET and the Scottish transmission licensees have recently identified scope to advance the connection dates of 450MW of Scottish renewable generation (both transmission-connected and distributed generation that would otherwise be delayed by the requirement for wider works on the transmission system) 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 also set out that, whilst the BETTA derogation remains in place and to avoid undue discrimination, we are '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.

Extending the principle of over-selling would have the immediate benefit of allowing the 450MW of renewable generators to advance in the queue. This will lower carbon dioxide emissions from electricity generation as this renewable generation displaces fossil fuel based generation. But we were also clear that extending the principle might give rise to higher constraints costs against a background of significant increases in both the volume and cost of constraints.

We expressed our view 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.

We explained that 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, the impact on competition in generation, the impact on sustainability and the impact on security of supply. We also noted that there are important statutory requirements driven by European legislation⁶ and domestic legislation that requires us to be satisfied that grid access arrangements do not discriminate unduly between different transmission users. We explained why we do not think there is any objective justification for the current differential treatment of generators where some generators are allowed access and others have to wait until network reinforcement is completed based solely on criteria which are linked to a point in time. We also restated our view that generators – including those benefitting from the BETTA derogation – do not have any defined, long term rights to access the system.

We proposed that the approach would immediately apply to the 450MW of renewable generation which the transmission companies have identified as being capable of

⁵ British Electricity Trading and Transmission Arrangements, implemented in April 2005.

⁶ Electricity Directive 2003/54/EC

advancement. We also set out that 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. Although we consider all applications for derogation on their merit, it is likely that the principles that underpin our 'minded-to' decision will apply to generators in comparable situations throughout GB, whether they are connected to the transmission or distribution network. We explained, for the avoidance of doubt, that 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.

We said that we were now satisfied that the issue of constraints costs is being properly considered and debated by the industry including through the normal industry processes associated with NGET's two modification proposals – Connection and Use of System Code ('CUSC') Amendment Proposal CAP170 (Category 5 System to Generator Operational Intertrip Scheme) and charging methodology modification proposal ECM-18 (locational BSUoS).

We also noted that it is intended that this approach is adopted in the interim period until the new, enduring access arrangements are in place. It does not have any implications for the decisions the Authority will take in respect of proposals for the enduring access arrangements. We noted that whilst we have every confidence in the TAR process and timetable, we cannot rule out the need to revisit this approach and the principle of overselling in general if, for example, there was a significant delay to TAR or other unforeseen developments. In such circumstances, we made clear that given the need to avoid undue discrimination we 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.

Finally, we recognised that our 'minded-to' decision may increase the level of constraints costs. However, we set out our view that 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 noted that 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.

Following the publication of the March 2009 open letter, on 30 March 2009⁷ we published a further open letter, discussing the implications of our proposed interim approach for distributed generation. The purpose of this further open letter was to draw our consultation to the attention of distribution network operators (DNOs). The letter set out our expectation that, depending on the outcomes of the consultation, DNOs will also need to facilitate on a non-discriminatory basis the early connection of generation to their distribution systems.

Summary of responses

We received twenty responses to the March 2009 open letter, fifteen of which supported Ofgem's proposed interim approach to GB SQSS derogations. Of the remaining respondents, one supported our 'minded-to' position in principle, two opposed it and two withheld their views.

⁷<http://www.ofgem.gov.uk/Networks/ElecDist/Policy/DistGen/Documents1/Derogation%20letter%20to%20DNOs%20300309.pdf>

All non-confidential responses are available on Ofgem's website⁸, and are summarised below according to the following key themes we have identified:

- Facilitating earlier connection
- Impact on distributed generation
- Constraints costs
- Scope of derogation
- Interaction with other measures

Facilitating earlier connection

All of the respondents who supported our 'minded to' position agreed that the proposed interim approach to GB SQSS derogations would facilitate earlier connection of new generation, particularly renewables. Four considered that this accelerated connection of renewable generation would help realise the Government's climate change and renewable energy targets. A further two respondents, one of whom supported and one of whom opposed our proposed approach, considered that the BETTA derogation unduly favoured some generators by allowing such generators earlier connection solely on the basis that they had secured or applied for a connection to the network by 1 January 2005.

Impact on distributed generation

Several respondents commented on the impact of the approach on the connection of distributed generation. A number commented that the approach recognises that the connection of small generators to the distribution network should not be delayed because they have only a negligible impact on the transmission system. One respondent also considered that Ofgem's proposed approach was consistent with one of the alternative proposals (WGAA1) developed by the working group considering CUSC Amendment Proposal CAP167, which the respondent considers seeks to clarify the criteria that are used to determine whether the connection of a small embedded power station to a distribution network will have a significant impact on the transmission system.

One respondent agreed that, as set out in Ofgem's open letter to DNOs of 30 March 2009, as a distribution licensee it will be necessary for it to engage in the consultation process on NGET's locational BSUoS charging proposal. This respondent noted it is possible that changes may be needed to DNOs charging methodologies and statements.

Constraints costs

One respondent agreed with Ofgem that it is likely that costs would be low in the first year, and would take time to reach National Grid's estimate of £40 million per annum⁹. Two respondents considered that the benefits of connecting new renewable generation would outweigh any resulting increase in constraint costs.

However two respondents did not agree that the cost increase is likely to be modest. One considered that, contrary to Ofgem's expectation set out in the March 2009 open letter, new generation connecting in Scotland would be expected to displace generation in England and Wales. This respondent also doubted the effectiveness of NGET's initiatives to manage the costs of balancing actions. Another respondent considered that there was no basis for claiming market power would be absent and also suggested that renewable generation is likely to be constrained off (at a high price) as a result of the derogation.

Another respondent considered that further analysis was required to better understand constraints costs, and therefore withheld their view on our proposed approach.

⁸ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=122&refer=Networks/Trans/ElecTransPolicy/tar>

⁹ This is the indicative cost provided by NGET of advancing the connection of the 450MW. Please see our February 2009 open letter for further information on this.

A number of respondents also commented on Ofgem's view that the issue of how best to manage and recover the costs of constraints is distinct from the question of whether the derogation should be extended. Four respondents agreed and two disagreed that the two issues should be considered separately. Of those who disagreed, one respondent considered it important that the constraints costs resulting from the derogation should be targeted back to the generators that have caused these costs.

Interaction with other measures

A number of respondents commented on the interaction of Ofgem's proposed approach to GB SQSS derogations with NGET's proposals on locational BSUoS¹⁰ and CAP170 (Category 5 system to generator operational intertripping scheme)¹¹. Two respondents considered that the implementation of locational BSUoS charging and/or CAP170 could impact upon the costs a generator will face, and therefore its decision to seek earlier connection. Another respondent considered that it was unacceptable for Ofgem to link the need for immediate implementation of locational BSUoS and CAP170 to a decision on interim queue advancement. Several respondents were critical of the process that has been followed in respect of these proposals.

One respondent considered that the proposed interim approach is a variant of another CUSC Amendment Proposal – CAP164 (Connect and Manage) – which had been raised by NGET as part of the suite of proposals aimed at reforming the enduring transmission access regime. This respondent considered that it is therefore inappropriate for Ofgem to implement decisions based on potential CUSC amendments that have not yet been analysed (for example, through an impact assessment) or decided upon. This respondent also considered that the four week consultation period on the proposed derogation is too short.

Two respondents did not agree that existing generators do not have enduring access rights.

Scope of derogation

A number of respondents commented on the extension of the interim approach beyond the 450MW of renewable generation identified by NGET. Several respondents welcomed Ofgem's willingness to extend the principle of overselling beyond the 450MW. However one respondent noted that any extension must not compromise the technical integrity of the system. In addition, one respondent expressed concern that there was no cost-benefit test or limit on the application of the derogation.

Respondents also requested clarity on a number of other issues. Two respondents considered that it was unclear how long the derogation would be applicable. On this point one respondent noted there was no firm definition of when the TAR process would be considered complete.

Another respondent noted that there are locations on the transmission system where there is insufficient network capacity in remote areas for all generation to connect. This respondent suggested it would be helpful to clarify what is meant by 'local connection works', to ensure that the need for any new local transmission infrastructure is not confused with reinforcement of the wider system.

One considered that the duration and conditions of any derogation must be carefully considered so as to provide certainty to generators that are able to connect as a result of the derogation.

One respondent welcomed the approach, but considered that a more holistic approach to system operation would allow more efficient use of existing system capacity. This

¹⁰<http://www.nationalgrid.com/uk/Electricity/Charges/modifications/uscmc/>

¹¹<http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/currentamendmentproposals/>

respondent considered that in the area it was seeking connection, optimising use of the system could go further by actively managing complementary resources of large scale hydro and all forms of intermittent generation. This respondent considered that the intermittency of wind power could be managed by using reliable forms of generation only when the wind stopped blowing.

Ofgem's views

We welcome all responses and note the support of the majority of respondents for our proposed interim approach.

We note that a number of respondents considered that our proposed interim approach recognises the very small impact of connecting small distributed generation, and one respondent commented that it was consistent with one of the options proposed under CAP167. We do not agree that it can be inferred from our proposed interim approach that connecting small distributed generation will have a small impact on the transmission system. Rather, we think that the principles which underpin our interim approach are likely to apply equally to distributed generation because we do not think there is any objective justification for the differential treatment of generators – whether connected to the transmission or to the distribution system - solely on criteria which are linked to a point in time. We recognise that there are interactions with our proposed interim approach and other areas of work, including CAP167. However, for the avoidance of doubt, the Authority has not yet made its decision on CAP167 and will consider CAP167 on its merits.

We also note that distribution network operators have similar legal obligations to transmission operators to have connection and access arrangements that are non-discriminatory. There are already significant volumes of distributed generation connected in Scotland – and some of this generation is owned by the companies that also own the relevant distribution networks. Any arrangements that delay the connection of new distributed generation could also therefore give rise to concerns about undue discrimination in the arrangements for connecting to and using the distribution network.

As we noted in our open letter to DNOs of 30 March 2009, DNOs will need to continue to advise NGET, in line with their existing CUSC obligations of any connection applications by distributed generation which may have transmission system implications.

We welcome the comments of one distribution licensee about the need to engage in the process for locational BSUoS, and note this respondent's comment that changes may be required to the DNO's charging methodologies and statements as a result of this. We further note that in our open letter to DNOs of 30 March 2009 we also recommended that they consider the potential implications of these developments when establishing their contractual arrangements with distributed generation.

We note that some respondents raised concerns about the scope for the interim approach to increase constraints costs, and the need to ensure appropriate targeting of costs. We note that several respondents commented on interactions with locational BSUoS and CAP170. We continue to consider that the issue of how best to manage and recover the costs of constraints is separate and distinct from the question of whether derogation should be granted to facilitate earlier connection. We consider that our consideration of locational BSUoS and CAP170 is separate and distinct from our proposed interim approach for derogations, and we do not agree with the respondent who considered that the interim approach was being used as leverage to implement CAP170 and locational BSUoS. The issue of how best to manage and recover constraint costs is an important one, whether or not we approve the derogation requests given the rapid escalation in the volume and costs of constraints over the last few years. For the avoidance of doubt, we do not consider that the interim approach would need to be amended solely as result of a decision to implement or a decision to reject CAP170 and/or the proposal to introduce locational BSUoS.

With regard to interactions with the longer term measures being developed under TAR, as we set out in the March 2009 open letter, whilst we have every confidence in the TAR process and timetable, we cannot rule out the need to revisit our decision on this approach due to a delay to TAR (for example if there was a lengthy legal challenge to any decision, or the Secretary of State were to take powers to make changes necessary to implement transmission access reforms¹²) or other unforeseen circumstances. 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 note one respondent considered it inappropriate to implement decisions based on other CUSC amendment proposals (such as CAP164) that have not yet been fully analysed through an impact assessment, and that the four week consultation period is inappropriate. As noted above in respect of CAP167, we recognise there are interactions between our proposed interim approach and other areas of work, including the proposals being considered as part of the wider TAR measures. We do not agree however that this precludes us from taking this approach in the interim period until longer term measures are in place. We continue to consider there are benefits of this approach in the interim period, and the longer term proposals (including CAP164) will be considered separately by the Authority. Our decision on the approach in the interim period does not have any implications for the decisions the Authority will take in respect of proposals for the enduring access arrangements.

We also think that the consultation period was reasonable in these circumstances. We and other stakeholders have already consulted widely on these issues through the TAR process. There has been extensive industry discussion, debate and analysis through the various working groups looking at enduring reform. And we are mindful of the benefits of accelerating the connection of new, predominantly renewable generation to the transmission system.

We note that some respondents do not agree that existing generators do not have enduring access rights. We do not agree with their assessment. The reasons for our position are as follows. The CUSC is a modifiable document that was introduced through primary legislation. It has therefore always been clear to all users that any rights they hold are capable of being modified in the future through the modification process.

The existing arrangements do not, in our view, confer any enduring long term rights as there is no requirement on generators to make commensurate commitments to pay for those rights. Generators can (and have) relinquished their rights at one year's notice without any ongoing obligation to pay for access rights. And the existing arrangements do not provide generators with any certainty over the future price of these rights. The price of their access rights are determined by NGET's charging methodology. This is also open to modification and changes have been made to the methodology that has changed the basis on which generators charges are calculated. Generator charges can vary year from year even if the methodology remains unchanged because of changes in the underlying data used to calculate charges. NGET has, on previous occasions, consulted on making changes that would have seen the introduction of well defined long term rights for generators through, for example, the introduction of long term, fixed price rights with matching commitments to pay for those rights, irrespective of use, but these were not progressed due to limited support from generators and other consultation respondents.

But the nature of generators' existing property rights are not directly relevant to the decision set out in this letter because the derogations apply to newly connecting generators and do not impact on the rights of existing generators in any way. As always, parties whose views differ from our own will have an opportunity to express those views and their reasoning through the normal process of industry consultation before any modifications are made and we will consider carefully those views in relevant decisions.

¹² Part 5, section 84, Energy Act 2008.

We note that some respondents requested clarity on the cost benefit analysis required for a derogation, and the status of our derogations guidance in our decision making process. As we set out in our minded to position, the Directive prohibits any undue discrimination in the arrangements for access to the transmission network. We think this requires us under the current arrangements where generators, once connected, are only committed to pay access charges for one year, to offer broadly similar terms to all generators irrespective of the date of their connection to the system. The results of any cost benefit analysis cannot override the requirements to avoid undue discrimination. Any cost benefit analysis would therefore need to consider whether the level of overselling of transmission capacity was appropriate – given the identified costs and benefits. And if it suggested that it was not it would be necessary to consider the arrangements for all generators and would not be a basis for refusing a derogation request and denying access to the last generator seeking connection or those that connected after an essentially arbitrary date.

As we set out in the March 2009 open letter, we will consider each application on its merits and by reference to the derogations guidance and the matters set out in our letter of 19 January 2009¹³. However, we have attempted to identify the broad principles we would assess any request against why this analysis is unlikely to be pivotal to our decision in light of the network operators' legal obligations to avoid undue discrimination.

We agree that careful consideration will need to be given to the duration and conditions of any derogation. For the avoidance of doubt (and as set out in our March 2009 open letter) our proposed approach is for an interim period only until, and subject to, the timely and successful implementation of enduring access arrangements.

We also agree that it is important to ensure technical integrity of the system is not compromised. We would not consider it appropriate to extend or maintain derogations if there was a risk that the technical integrity of the system would be impaired.

We note one respondent considered a more holistic approach should be developed and that the intermittency of wind power could be managed by using reliable forms of generation only when the wind stopped blowing. We note that the industry framework provides for parties to raise whatever changes parties consider may be required.

With regard to clarification of what is meant by 'local connection works'. We would observe that local works in this context are those that have been identified by the transmission licensees in the course of their consideration of which users may be able to connect earlier and which, if completed would enable connection in advance of wider system infrastructure works. We can confirm that our approach is intended to apply to 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.

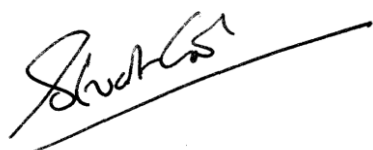
Decision and way forward

In light of the issues discussed above, whilst the BETTA derogation remains in place and to avoid any undue discrimination in the terms for connecting and accessing the transmission system, we consider it is appropriate to extend the principle of over-selling for an interim period until, and subject to, the timely and successful implementation of enduring access arrangements.

¹³<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=15&refer=Networks/Techn/TechStandds/Derogtns>

We expect NGET and the Scottish transmission licensees to work together to submit appropriate derogation applications in the near future, to facilitate the connection of the 450MW and other generation in a comparable situation where the scope to advance connection dates is limited by the need to grant a derogation from the GB SQSS.

Yours sincerely

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

Stuart Cook
Director, Transmission