



Alison Kay
Commercial Director
National Grid
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

*Promoting choice and
value for all customers*

Your Ref: GB ECM-18
Our Ref: GB ECM-18
Direct Dial: 020 7901 7009
Email: stuart.cook@ofgem.gov.uk

Date: 17 June 2009

Dear Alison,

GB ECM-18 – Locational BSUoS

On 22 May 2009 National Grid Electricity Transmission plc (NGET) submitted to the Authority¹ the Conclusions Report for Use of System Charging Methodology modification proposal GB ECM-18, Locational BSUoS². The modifications in this report were developed by NGET in response to our letter to NGET dated 17th February 2009 requesting NGET to conduct an urgent review to consider (and if appropriate, consult on) whether urgent changes to the existing commercial and charging arrangements for access to the GB transmission system are necessary - to more effectively manage the costs of constraints, and to ensure that any constraint costs are recovered on an equitable basis from customers, suppliers and generators.

Given the significance of the changes proposed, Ofgem intends to conduct an impact assessment on the proposal. In the course of preparing this impact assessment, we have reached the view that additional analysis will be necessary for us to assess the potential impact of the proposal. We have further realised that it is unlikely that NGET would be able to carry out such analysis in time to allow us to conduct an impact assessment consultation prior to making an informed decision within the three-month time window set out in NGET's Standard Licence Condition C5. We are therefore asking NGET to withdraw the current version of the Conclusions Report on GB ECM-18 prior to 19 June 2009 so that the proposal does not enter into force by default.

Context

In accordance with Standard Licence Condition C5 of NGET's Transmission Licence, NGET's report on GB ECM-18 sets out:

- a) the terms originally proposed for the modification;
- b) the representations made by Users;
- c) any changes made to the terms of the modification intended as a result of such representations;
- d) how the intended modification better achieves the relevant objectives; and
- e) a timetable for implementation of the modification.

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² The term 'BSUoS' stands for 'Balancing Services Use of System'. Further details are set out on NGET's webpage: <http://www.nationalgrid.com/uk/Electricity/Charges/modifications/uscmc/>.

Currently the costs of operating the system are recovered equally from generators and suppliers across Great Britain. Under GB ECM-18, the costs arising as a result of the management of transmission constraints due to the non-compliance of a derogated boundary would be targeted to generators behind the boundary i.e. on a locational basis.

Further analysis

Ofgem recognises that GB ECM-18 represents a significant change from the current methodology for charging the costs of constraints. For this reason, Ofgem considers that modification proposal GB ECM-18 meets the "importance criteria" set out in section 5A of the Utilities Act and, before making a decision on this proposal, we intend to carry out an assessment of the likely impact of implementing the proposal.

Standard Licence Condition C5 requires Ofgem to assess proposed modifications in the light of whether they better achieve the relevant objectives which relate to:

- Cost reflectivity;
- Competition; and
- The developments in transmission licensees' transmission businesses.

In addition, Ofgem's impact assessment on a charging modification proposal must also consider the impact of NGET's proposal on factors that the Authority must have regard to when carrying out its functions including its principal objective and statutory duties.

We consider that a thorough assessment of the impact in all relevant areas requires us to conduct both quantitative and qualitative analysis of the potential effects and changes that might result from this modification proposal. For example, we need to understand better the full range of potential impacts on generator charges as well as the potential for changes to generator behaviour as a result of GB ECM-18. We also consider that we need to assess the effect of the proposal on competition and hence to satisfy ourselves that the proposal better achieves the relevant objectives³ set out in Standard Licence Condition C5. Ofgem has received some data from NGET to enable us to perform our own analysis in these areas. However, this has been insufficient to allow us to assess the proposal fully so that our consultation is well informed and the Authority's final decision is taken on the basis of the best available information, including responses to consultation.

As a result, we are asking NGET to undertake further analysis and to give further consideration to the impacts of the proposal, and in particular to consider the extent to which the proposal better achieves the relevant objectives. Examples of the type of analysis that we would expect to see in a second version of the Conclusions Report include:

1. An assessment of the effect of GB ECM-18 on generators in different locations (e.g. in relevant zones) and using different types of fuel (e.g. wind, nuclear, gas etc.) This will need to include an assessment of the impact on the wholesale price, assuming that the proposal, if implemented, does not lead to any significant changes in the output and typical bid/offer prices by generators under current market conditions. In addition, the analysis should include sensitivity analysis around potential changes in the market conditions such as changes in coal/gas prices and in the relative position of coal/gas fired plant in the merit order.
2. An analysis of the likelihood of changes in the output and bid/offer prices by generators in response to the proposal, together with the resulting impact on costs and volume of constraints and the wholesale price, assuming that no generators have any significant market power and that bid/offer prices are broadly cost-reflective. This analysis should look at the likely impact of the proposed charges on stations running costs and their position in the merit order, and should also include similar range of sensitivities as set out in 1 above.
3. An analysis of the likelihood of changes in the output and bid/offer prices by generators in response to the proposal together with resulting impact as mentioned in 2 above, but assuming that generators do have market power. This analysis should look at concentration ratios in relevant zones and consider the historic

³ As required by Stand Condition 5, 3(c)(iv)

bids/offers by different types of plant relative to average bid prices in other zones observed for plant with similar operating characteristics. For an example of this type of analysis we would refer you to Ofgem's impact assessment on CUSC Amendment Proposal CAP170⁴.

We recognise that the need for NGET to undertake this analysis and to submit a second version of the Conclusions Report will delay our decision on this proposal. Indeed, this analysis may lead to further issues arising that will need consideration before the proposals can be finalised. However, we must ensure that any significant impacts and unintended consequences of any measures that NGET proposes are fully understood and that our decisions are well informed.

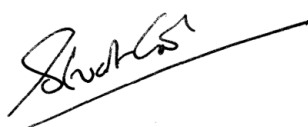
Way Forward

Under paragraph 4 of Standard Licence Condition C5, NGET will not make any modification to its use of system charging methodology where the Authority has, within 28 days (or within three months if the Authority intends to undertake an impact assessment) of the report being furnished to it, given a direction that the modification shall not be made. We intend to undertake an impact assessment of the modification but, in order that we may consider this proposal with the further analysis referred to above, we are asking National Grid to withdraw the current version of the Conclusions Report on GB ECM-18 prior to 19 June 2009 so that the proposal does not enter into force by default⁵.

Once you have had the opportunity to consider the additional analysis required we should be grateful if you would indicate when you expect to resubmit the Conclusions Report consistent with your obligations under Standard Licence Condition C5.

We look forward to hearing from you.

Yours sincerely,



Stuart Cook
Director, Transmission

⁴ <http://www.ofgem.gov.uk/Licensing/ElecCodes/CUSC/Ias/Documents1/090521CAP170IA.pdf>

⁵ NGET's report on GB ECM-18 was submitted to the Authority on 22 May. In accordance with Standard Licence Condition 5, the Authority has 28 days (i.e. until 19 June) to issue a direction that the modification shall not be made, or to signal its intention to undertake an impact assessment.