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Dear Colleague,

Consultation on the discount for small transmission connected generators from 31 March 2011

This letter consults on options and Ofgem's proposed approach to extend the "small generator discount". We consider that this change is made necessary by the recent launch of Project TransmiT¹. The "small generator discount" is set out in Standard Licence Condition (SLC) C13 "Adjustment to use of system charges (small generators)" of the electricity transmission licence ("the Licence").

In Scotland, the 132kV network is defined as Transmission whereas in England & Wales, the 132kV network is defined as Distribution. Generators which are connected to the 132kV network in England & Wales benefit from being treated as negative demand. The small generator discount is intended to ensure an equivalent treatment of 132kV-connected generators in Scotland and in England & Wales. Offshore, generation projects connected to the National Electricity Transmission System (NETS)² at 132kV are defined as Transmission. Any sub-100MW offshore generation projects connected at 132kV will be covered by the small generator discount.

SLC C13 requires National Grid Electricity Transmission plc (NGET) to discount the use of system charges for "eligible generators"³ by a designated amount and to recover the revenue shortfall from demand users non-locationally based on peak demand. Further detail on the history of the small generator discount can be found on our website⁴. At present, this condition will cease to have effect on 31 March 2011.

Background

Embedded benefits for small generators connected to distribution networks

Under the Transmission Network Use of System (TNUoS) charging rules applied by NGET, small (sub-100MW) generators connected to the distribution network (Distributed Generation, or "DG") are treated as negative demand.

Compared to other generators situated in the same geographical region, sub-100MW DG:

- Avoid the generation TNUoS tariff; and

¹ Launched on 22 September with the publication of a Call for Evidence paper. Follow link: <http://www.ofgem.gov.uk/Networks/Trans/PT/Pages/ProjectTransmiT.aspx>.

² The NETS (currently split into three transmission licence areas which are defined as England and Wales, South of Scotland and North of Scotland) will be extended into offshore waters at a point where assets are treated as part of the NETS.

³ "eligible generator" has the meaning given in SLC C13 of the transmission licence, as attached in Appendix 1 to this letter.

⁴ <http://www.ofgem.gov.uk/Networks/Trans/Archive/ElecTrans/TADG/Documents1/Small%20Generators.pdf>

- Are credited with the demand TNUoS tariff⁵.

In combination, these effects are referred to as “embedded benefits”.

The Wider TNUoS tariffs⁶ for both Generation and Demand comprise two components; a locational element and a non-locational residual element.

- The locational element reflects the average long-run forward-looking costs of connecting an incremental mega watt of generation at different locations on the wider interconnected infrastructure of the NETS. It relates to the cost of all investments in “locational” assets such as lines and cables (historic or new) which provide access to the NETS. This cost is averaged within a set of defined zones for generator users and another set of zones for demand users. The Wider TNUoS tariff for demand is broadly equal and opposite of that for generation at the same geographic location.
- The residual element is non-locational, i.e. one uniform value for all generation, and with another uniform value for all demand. This element is aimed at recovering the required total revenue, as well as achieving a pre-defined ratio between the TNUoS charges recovered from demand and generation.

Given the composition of Wider TNUoS tariffs, the embedded benefits are approximately equal to the sum of the generation and demand residual tariffs, since the locational elements broadly cancel each other out at the same geographic location. The total net benefit is therefore the generator residual tariff avoided by the DG plus the demand residual tariff avoided by the supplier (or paid directly to the DG). This is estimated by NGET to be worth ~£20-22/kW based on the sum of the current generation and demand residuals.

Features of SLC C13

SLC C13 “Adjustment to use of system charges (small generators)” was introduced to the Licence at the implementation of the British Electricity Trading and Transmission Arrangements (BETTA) on 1 April 2005. It was in recognition of the fact that 132kV is defined as Transmission in Scotland, but as Distribution in England and Wales. The designated amount of the discount was separately directed by the Authority⁷ as 25% of the total residual element of the TNUoS charges.

The number of generators that meet the criteria for treatment as small transmission connected generators and therefore become eligible for the small generator discount within the current charging year (2010/11) has recently increased to reflect the commencement of the offshore regime on 22 July 2010. The development of offshore transmission has meant that five sub-100MW generation projects connected at 132kV (which is defined as Transmission) are scheduled to be part of the NETS within this charging year and will be covered by this discount. This has increased the total MW of generating plant qualifying for the small generator discount by approximately 400MW.

For 2010/11, the effective annual value of the small generator discount equates to a reduction of £5.46/kW. Thirty generating plant, totalling 1386MW, qualify for the small generator discount, totalling approximately £7.5m per annum. This shortfall in revenue collected from eligible generators is met by all GB demand customers and spread across a charging demand base – representing an additional cost of about £0.13/kW to the demand tariff applicable to Half Hourly (HH) demand users and £0.02 p/kWh to the tariff applicable to non-HH demand users.

⁵ Depending on its meter registration, the DG’s output would either “sit behind” a supplier and have its output deducted from a supplier’s demand requirements and reduce a supplier’s TNUoS charge, or a DG may be paid directly the demand TNUoS tariff.

⁶ Generators directly connected to transmission are also subject to a Local TNUoS tariff which reflects the costs of the infrastructure assets that are local to the generator. The Wider tariff reflects the costs of the infrastructure assets in the deeper transmission infrastructure.

⁷ Direction issued by the Gas and Electricity Markets Authority to National Grid Company Plc - Revision of Transmission Network Use of System Charges, 28 February 2005. Follow link:

<http://www.ofgem.gov.uk/Networks/Trans/Betta/Publications/Documents1/9824-6405.pdf>

Developments since BETTA

A discussion document by Ofgem in May 2006⁸ examined the appropriate commercial and technical issues associated with DG on an enduring basis. At the request of industry, the Transmission Access Development Group (TADG) group⁹ was subsequently set up to consider enduring arrangements and the applicability of agency models. The TADG working group published its final report on 30 July 2007, indicating four possible agency strawmen to address the treatment of DG within the enduring transmission arrangements. It is worth noting that whilst the group raised the question, without agreeing on conclusions, about the cost-reflectivity of the TNUoS embedded benefits, it did not consider explicitly the point of the expiry of the small generator discount in April 2008.

In an open letter from Ofgem which accompanied the TADG report¹⁰, we set out our view that, amongst other things, there is a need to review the current transmission charging arrangements to ensure that they reflect the costs imposed on the transmission network and give appropriate credit for benefits provided, taking into account the impact of DG on such costs. This promotes the economic development of the transmission network and helps to ensure that competition in generation and supply takes place on a level playing field.

Since 2008, NGET has taken forward discussions about the outstanding concern regarding the cost-reflectivity of the embedded benefits and the process for developing an enduring solution to replace SLC C13 through the relevant industry fora¹¹.

Previous licence modification processes

There have been two separate modifications to the text of SLC C13 since its introduction in February 2005. These modifications have been requested by NGET. In addition to extending the expiry date of the small generator discount from 31 May 2009 to 31 March 2011, on the second occasion Ofgem also strengthened NGET's obligation to use 'best endeavours' to develop and implement enduring arrangements by this date.

All the relevant documentation detailing the previous modification processes can be found on our website.¹²

Developments since March 2009

Industry discussion

In January 2010 NGET issued a pre-consultation document GB ECM-23 "Transmission Arrangements for Distributed Generation"¹³. The pre-consultation document set out two potential agency modelling solutions identified by NGET: the Gross Nodal Supplier Agency Model (GNSAM) and the Net DNO Agency Model.

The majority of the industry response to the pre-consultation document opposed the adoption of a gross charging arrangement. However, NGET noted that the respondents did not put forward any alternative arrangements that NGET considered to better meet the relevant objectives¹⁴ of the Licence. Recognising that the 2006/07 TADG working group¹⁵ had already undertaken a significant amount of work on debating the issues and developing gross and net charging models, NGET undertook a series of working group meetings to address respondents' concerns about the gross agency solution put forward in the pre-consultation. These

⁸ Enduring transmission arrangements for distributed generation: a further document, 31 May 2006.

⁹ All documentation from the TADG working group can be found at:

<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TADG/Pages/TADG.aspx>

¹⁰ TADG working group report and next steps 30 July 2007. Follow link:

http://www.ofgem.gov.uk/Networks/Trans/Archive/ElecTrans/TADG/Documents1/070730_TADG_Covering_Letter_final.pdf

¹¹ <http://www.nationalgrid.com/uk/Electricity/Charges/TCMF/>

¹² Follow link: <http://www.ofgem.gov.uk/Networks/Trans/Archive/ElecTrans/TADG/Pages/TADG.aspx>

¹³ Available from NGET's website: <http://www.nationalgrid.com/NR/rdonlyres/B630B1A6-679B-4D13-8BF8-B597189DB6A1/39333/GBECM23TransmissionArrangementsforDistributedGener.pdf>

¹⁴ SLC C5 (5) of NGET's Licence.

¹⁵ All documentation from the TADG working group can be found at:

<http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TADG/Pages/TADG.aspx>

discussions were conducted on the basis of the significant amount of work already undertaken by the 2006/07 TADG working group.

Discussions in the GB ECM-23 working group allowed NGET to further refine its proposals to a stage where they were ready for further consultation under the current charging governance arrangements. NGET was able to formulate the details of a workable enduring solution and outline a potential timeline to implementation of the necessary industry framework changes by 1 April 2011, details of which were presented at the Transmission Charging Methodologies Forum on the 21 July 2010¹⁶. In accordance with timeline developed by the working group to implement an enduring solution from 1 April 2011, NGET intended to publish a further consultation on TNUoS charging modification proposal GB ECM-23 in July 2010.

However, in June 2010, Ofgem's plans to undertake a review of the existing transmission charging arrangements were made public. In light of this announcement, NGET decided to delay the publication of charging consultation GB ECM-23 until after further clarity was available on the proposed review. This decision was based on NGET's own assessment that the further consultation on GB ECM-23 would make significant proposals that reach across the entire spectrum of charging arrangements that were likely to fall within the scope of the proposed review and the residual element of transmission charges in particular. The decision to delay publication of GB ECM-23 was circulated to working group members on 28 July 2010 and formally set out in an open letter published on 21 September 2010¹⁷.

Project TransmiT

On 22 September Ofgem launched 'Project TransmiT' - our independent and comprehensive review of transmission charging arrangements and associated connection arrangements - with the publication of a Call for Evidence paper.

The Call for Evidence document confirmed that the initial focus of Project TransmiT will consider charging arrangements and associated connection issues.

The objective of the review is to ensure that appropriate arrangements are in place to facilitate timely transition to low carbon energy sector while continuing to provide safe, secure, high quality network services at value for money to existing and future consumers. We have asked for views on the scope and priorities of the review, evidences and analysis relating to the case for reform. In particular, we are seeking views at this initial stage on whether the existing transmission charging arrangements facilitate the achievement of this objective.

Following consideration of the responses to our Call for Evidence, we will look to prioritise those areas of the current charging regime requiring the most urgent attention.

NGET letter

NGET wrote to Ofgem on 15 October 2010 informing us of their view that it is no longer possible to implement an enduring transmission charging arrangement solution from 1 April 2011, when SLC C13 ceases to have effect.

The reasons stated in support of this view include:

- It is no longer practical to complete work on an enduring charging solution in time for a 1 April 2010 implementation date given the potential resource, timing and policy assessment interaction associated with the anticipated scope and timeline of Project TransmiT. This interaction was not envisaged at the time of the previous discussions and licence modification decision.

¹⁶ <http://www.nationalgrid.com/uk/Electricity/Charges/TCMF/>

¹⁷ Available from NGET's website, follow link: http://www.nationalgrid.com/NR/rdoonlyres/44201E6D-B4A1-4D94-BF50-342350ED3D69/43170/IndustryLetter_final_review.pdf

- There is still substantial amount of work required to develop the DG charging solution, along with other associated changes (e.g. new commercial interfaces). NGET is of the opinion that it is not appropriate to push forward with a package of measures requiring a financial and resource commitment from both NGET and industry to develop the associated Information System and policy solutions that could result in nugatory work.

In light of the above, NGET is of the view that it is therefore necessary to consider the options and associated implementation issues for dealing with the cessation of SLC C13 by the 31 March 2011 deadline.

Options for 31 March 2011

Expiry of SLC C13

There are two available policy options for dealing with the expiry of SLC C13 at the 31 March 2011 deadline. These are to:

- a) Maintain the current level of the small generator discount by extending the expiry date of the current licence condition beyond 31 March 2011. There are two sub-options associated with this approach:
 - i. Extend the licence condition expiry date by an agreed period at the current value of the designated sum amount, or
 - ii. Extend the licence condition expiry date by an agreed period, but allow the Authority to set an alternative value for the designated sum amount.
- b) Allow the licence condition to expire on 31 March 2011 (i.e. do nothing).

Option (ai) represents the smallest change from the current situation. Whilst it does not deal with the well documented concerns on the cost-reflectivity of the current DG embedded benefits, this option at least does not make any existing problem worse or create new problems.

Option (a(ii)) can only have an advantage over options (ai) or (b) if the alternative designated sum represents an improvement in the cost-reflective treatment of all relevant generators. However, any change in the small generator discount is likely to result in changes in the discrepancy of transmission treatment across other boundaries between different categories of generators. A systematic review with a potentially longer consultation process would be required to ascertain whether a change is better than the current small generator discount. Given the extent of industry discussion to date, it is not practical for a more cost reflective designated sum to be developed before 1 April 2011 or for the associated licence modification process to paragraph 4 of SLC C13 to be completed.

Option (b) arguably removes any potentially unjustifiable discrepancy in TNUoS charges between 132kV-connected small (sub-100MW) generators and other transmission connected generators in Scotland. However, it would bring back the potentially undue disparity between 132kV-connected small generators in Scotland and offshore versus those in England and Wales. It is not clear without substantial analysis to ascertain whether there would be a net benefit. It is not practical for such analysis to be conducted and concluded before 1 April 2011.

In light of the above, we consider policy option (ai) to be the most proportionate and pragmatic approach.

'Best endeavours' obligation on NGET

During the course of discussion on the licence amendment process initiated by NGET's request in September 2008 to extend the small generation discount, we made it clear that we consider NGET to have a unique role and ability to drive process and the timely development of an appropriate solution in this area. Against this background, we considered it appropriate to

strengthen the obligation on NGET to encourage urgent progress in this area as soon as possible.

Following consultation with industry, a licence modification decision to amend SLC C13 was issued on 12 March 2009¹⁸. This modification extended the expiry point of SLC C13 to 31 March 2011 and established a new provision in paragraph 6 of SLC C13 including a requirement on NGET to use 'best endeavours' to develop and implement enduring electricity transmission charging arrangements by 1 April 2011. This decision also noted that we would give consideration to what, if any, enforcement action would be appropriate should NGET fail to develop an enduring solution in the timescales set out in SLC C13.

We note that developments and progress have been made in this area since March 2009. In particular, we note that the steps taken by NGET in reviewing with the industry the cost reflectivity of the transmission charging arrangements for DG, the establishment of the GB ECM-23 working group and the refinement of proposals to a stage where NGET were ready for further consultation under the current charging governance arrangements.

We have also considered NGET's arguments about potential interaction with the anticipated scope and timeline of Project TransmiT, and the influence that such factors had on the decision to delay publication of the further consultation GB ECM-23. In response, we recognise that this interaction was not envisaged at the time of the previous discussions and decision on the issue of SLC C13.

Acknowledging the potential resource, timing and policy assessment interactions associated with the anticipated scope and timeline of Project TransmiT and the development of an enduring solution required by SLC C13, we have established in further discussions and through further correspondence with NGET that:

- NGET remains committed to the development and implementation of an enduring solution to the discrepancy in treatment for different generators highlighted by SLC C13;
- Project TransmiT represents the best vehicle for the continuation of the work started through the development of GB ECM-23; and
- Where required, NGET will be providing resource, analysis and information in support of Project TransmiT.

We consider that this commitment will enable NGET to provide the analysis and interpretation to Ofgem to ensure that the insights of the GB ECM-23 working groups are not lost.

In light of the above, we are seeking views on whether it is appropriate to retain the 'best endeavours' obligation on NGET and extend the expiry period so that the obligation remains active until the cessation of SLC C13 or remove the obligation.

Ofgem's proposals

We propose to remove the current expiry date for the small generator discount replacing it with an extended discount period so that, at 1 April 2011 and until 31 March 2013, the small generator discount will continue to be based on 25 per cent of the total residual TNUoS tariff.

Our initial view of the approach to giving effect to this change would be to amend paragraph 5 of SLC C13, the current version of which is included in Appendix 1, in accordance with the powers contained in Section 11A of the Electricity Act 1989 to extend the expiry date to 31 March 2013.

¹⁸ Section 11A modification of standard condition C13 (Adjustments to use of system charges (small generators)), 12 March 2009. Follow link:
<http://www.ofgem.gov.uk/Networks/Trans/Archive/ElecTrans/TADG/Documents1/20090311ModificationtoSLCC13.pdf>

We also intend to retain the clause currently contained in paragraph 4 of SLC C13 which allows the Authority to issue a direction at any time stating that, with effect from 1 April immediately following the direction, the designated sum shall be set to zero, with the effect of setting the value of the small generator discount to zero. This will allow NGET to develop and implement an approved enduring TNUoS based solution before the expiry date of SLC C13.

In terms of the 'best endeavours' obligation, we recognise that the continuation of the small generator discount will be dependent on conclusions that may flow from Project TransmiT. We are therefore seeking views on whether it is appropriate to remove the 'best endeavours' obligation on NGET or retain and extend the expiry period so that the obligation remains active until 1 April 2013. To give effect to these options we would either amend paragraph 6 of SLC C13 in accordance with the powers contained in Section 11A of the Electricity Act 1989 to extend the expiry date to 1 April 2013 or delete the paragraph completely.

Views invited

We welcome views and comments on any of the issues raised above, but specifically on:

- Our proposal to change the expiry date of the small generator discount to 31 March 2013
- Our initial view of the approach to giving effect to this change; and
- Whether it is appropriate to retain and extend the 'best endeavours' obligation on NGET to implement an approved enduring charging solution no later than 1 April 2013 or remove the obligation.


We would like to hear the views of any interested parties regarding the issues raised in this letter. Written responses should be made by **29 November 2010** to: Anthony Mungall, OFGEM, 107 West Regent Street, Glasgow, G2 2BA.

Alternatively, comments can be emailed to anthony.mungall@ofgem.gov.uk marked "**Response on small generator discount**". If you wish to discuss any aspect of this document please contact Anthony Mungall, telephone 0141 331 6010.

Next steps

We intend to make a decision on the policy decision in December 2010. In the event that licence change is required, we will issue a licence modification consultation under section 11A in December 2010 stating our intention to continue with the small generator discount, leading to a final modification of licence condition changes before the end of January 2011. We understand from NGET that the indicative tariffs, in particular the adjustments to use of system charges for small generator discount¹⁹, to be published in December will reflect the different potential outcomes of this consultation, with their final tariffs to be published on or before 1 February 2011 (in accordance with the default notification timescales set out in the Connection and Use of System Code) reflecting the policy intention of our January 2011 document.

Yours faithfully,



Stuart Cook,
Senior Partner, Smarter Grids & Governance

¹⁹ Follow link: http://www.nationalgrid.com/NR/rdonlyres/533B314D-CE42-42CC-91C9B301508C98CF/17925/UoSCMI3R1FINAL_BSuSandCAP142_3.pdf

Appendix 1

Condition C13: Adjustments to use of system charges (small generators)

1. When calculating use of system charges (other than charges relating to the provision of balancing services) to eligible generators the licensee shall set a charge in conformance with the use of system charging methodology in accordance with standard condition C4 (Charges for use of system) less a designated sum.
2. When calculating use of system charges (other than charges relating to the provision of balancing services) to customers who are taking demand from the national electricity transmission system the licensee shall set charges in conformance with the use of system charging methodology in accordance with standard condition C4 (Charges for use of system) plus a unit amount (to be added to all such charges on a non-discriminatory and non-locational basis) such that the net effect of this condition on total sums charged for and recovered by the licensee in respect of the period in which this condition is in effect is zero. The licensee shall ensure that the net sums recovered for any given year are as far as practicable zero.
3. The licensee shall publish sufficient information in a timely manner such that all parties whose use of system charges are or may be adjusted in accordance with this condition are able to make a reasonable estimate of how use of system charges have been affected by the provision contained within this condition. To the extent that net sums recovered for any given year might not be equal to zero, the licensee shall also publish sufficient information to enable affected parties to make a reasonable estimate of how any over or under-recovery in respect of that year made pursuant to this condition will affect adjustments to charges for the following year.
4. The Authority shall be entitled to issue a direction pursuant to this condition at any time stating that, with effect from 1 April immediately following the issuing by the Authority of such a direction, the designated sum shall be equal to zero.
5. This condition shall have effect for the Licensee's charges for the period ending on 31 March 2011.
6. The Licensee shall use its best endeavours to develop and implement use of system charges for eligible generators under the use of system charging methodology, approved by the Authority, by 1 April 2011.
7. For the purposes of this condition:

"eligible generator"

means a generating station which:

- (a) is liable for generation transmission network use of system charges (or its equivalent) under the use of system charging methodology approved by the Authority in accordance with standard condition C4 (Charges for use of system); and
- (b) is connected to the national electricity transmission system at a voltage of 132 kilovolts; and
- (c) would not, on the basis of its maximum generating capacity, be liable for generation transmission network use of system charges (or its

equivalent) if it were connected to the distribution system of a licensed distributor rather than to the national electricity transmission system.

“designated sum”

means such sum as shall be directed by the Authority as soon as practicable after the determination of an approved use of system charging methodology in accordance with standard condition C4 (Charges for use of system).