

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: 38/11
Email: Project.TransmiT@ofgem.gov.uk

Date: 22 March 2011

Dear colleague

Project TransmiT: next steps on connections issues

Project TransmiT is Ofgem's independent and open review of transmission charging and associated connection arrangements. The aim of TransmiT 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.

As set out in our January 2011 letter¹ our immediate priorities are electricity connection issues and electricity transmission charging.

We have today published a separate letter on Project TransmiT². That letter seeks views on the work of our teams of academics, which is one input to our thinking on the appropriate way forward on electricity transmission charging, and sets out that once that work is finalised we expect to consult on the full range of emerging options.

This letter focuses solely on the next steps on the electricity connection issues we are considering. It sets out the high-level principles that we think are relevant to the development of new enduring electricity user commitment arrangements and the process for developing new arrangements. It also seeks views on the new Transmission Owner (TO) reporting obligation that we propose to introduce, to gather further information in support of arrangements to facilitate timely connections.

We welcome views on the connections issues discussed in this letter by **3 May 2011**.

Background

As noted in our January 2011 letter, respondents to our call for evidence generally supported the Connect and Manage regime for accessing the electricity transmission

¹ http://www.ofgem.gov.uk/Networks/Trans/PT/Documents1/110125_TransmiT_Scope_Letter_Final.pdf

² <http://www.ofgem.gov.uk/Networks/Trans/PT/Pages/ProjectTransmiT.aspx>

system³. However, respondents noted there are still significant issues hampering connection. Indeed, certain connection issues are considered by some to be as big a hurdle to projects connecting to the system as transmission charging is perceived to be. One of the biggest issues is the arrangements relating to user commitment.

In December 2010, we issued a consultation on options for delivering timely connections⁴. We have also supported the work by National Grid Electricity Transmission plc (NGET) to deliver interim pre-commissioning user commitment arrangements.

In our January 2011 letter, we set out that we now expected NGET to focus, as a matter of priority, on developing an enduring solution to user commitment. We set out that we expected NGET to carry out analysis on potential options and, if appropriate, submit a proposal to the Connection and Use of System Code (CUSC) Panel in February. We also noted that if we have concerns that NGET will be unable to develop and give effect to a suitable proposal to modify the user commitment arrangements, we will consult on initiating a Significant Code Review (SCR)⁵ to progress this specific area.

Electricity User Commitment

We are aware of the widespread concerns of users about the current electricity user commitment arrangements. We are not convinced the current arrangements⁶ strike the right balance of risk between new and existing network users, the network companies and consumers.

High-level principles

The overall aim of the regulatory framework is to encourage network companies to play a full role in the delivery of a sustainable energy sector and to deliver value for money network services for existing and future consumers. We think that the aim of enduring electricity user commitment arrangements should therefore be to ensure the efficient allocation of stranding risk between new and existing network users, the network companies and consumers. The arrangements should be consistent with the relevant legal and statutory framework. Amongst other things, they should ensure that excessive or inappropriate costs do not fall to consumers, should be transparent, proportionate, non-discriminatory and not act as a barrier to entry (including to renewables) or adversely affect security of supply.

³ Connect and Manage was introduced by Government in August 2011. Under Connect and Manage, generation can access the transmission system ahead of wider reinforcements being completed, subject to 'enabling works' being completed. More information is available on DECC's website:

http://www.decc.gov.uk/en/content/cms/consultations/improving_grid/improving_grid.aspx.

⁴<http://www.ofgem.gov.uk/Networks/Trans/PT/Documents1/121410%20timely%20connection%20draft%20letterdoc.pdf>.

⁵The Significant Code Review (SCR) process was introduced following our Code Governance Review (CGR). Final Proposals on the CGR are available on our website:

(<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=297&refer=Licensing/IndCodes/CGR>). Please also see our guidance on SCRs:

(<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=197&refer=Licensing/IndCodes/Governance>)

⁶ More information on the existing electricity connection arrangements is set out in the technical annex to our call for evidence:

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

We would welcome views on whether respondents agree with these high-level principles against which enduring arrangements should be developed, and if there other relevant principles.

Developing an enduring solution

In developing an enduring solution, we think that it is appropriate to consider options around two broad 'dimensions': the extent of assets protected by user commitment, and the extent to which the level of protection is adjusted to take account of the specific risks of the investment and/or generation project.

There are potentially options with different profiles in terms of the risk balance and the extent to which they take account of the risk profile of the relevant generation assets. Options that better reflect the generator circumstances do not necessarily have to increase the overall transmission stranding risks borne by consumers.

As noted in our January 2011 letter, we asked NGET to consider potential options for enduring user commitment arrangements. NGET submitted a proposal to the 25 February 2011 CUSC Panel. NGET's proposal, CUSC Modification Proposal 192 (Arrangements for Enduring Generation User Commitment)⁷ (CMP192), seeks to introduce into the CUSC a new methodology that it would use to determine individual generators' liabilities and the level of security required against these liabilities. At this stage, the draft proposal is high level, the detail of which will be developed in the CUSC working group process.

We would welcome views from respondents on the high level proposal as it currently stands and any areas where it may need to be further developed in light of the aims of TransmiT. To this end, we also urge stakeholders to respond to any consultations coming out of the CUSC working group process. Where appropriate, views expressed for the purposes of responding to this consultation on Project TransmiT should be fed into the industry process on CMP192 at an early stage. Given our initial views on the possibility of a Significant Code Review (see below), we expect CMP192 to be developed in a timely manner. We will also engage with the industry process and will, as appropriate, make our views known on the CMP192 proposal.

We strongly urge stakeholders to engage and commit to working constructively within the industry process, as we think this has the potential to deliver a timely solution.

Significant Code Review route

We will engage fully in the industry process. Although the implementation of the Code Governance Review (CGR) has provided us with the power to "send back" proposals due to deficiencies in the modification report such as insufficient assessment, incorrect legal text or other technical flaws, we consider that there remains a risk that the industry process may not deliver an enduring solution that is fit for purpose. There could therefore still be a case for Ofgem to initiate a Significant Code Review (SCR) to develop a solution.

⁷ The Amendment proposal is available on NGET's website:
<http://www.nationalgrid.com/NR/rdonlyres/D2D6F81D-7C3E-4049-8429-817E6A5DA657/45775/CMP192EnduringUserCommitmentv1.pdf>

At this stage, there are a number of things that might trigger us consulting on using a SCR, including (but not limited to) concerns that the industry process is not producing appropriate analysis in support of the proposal, and/or concerns about the scope of the proposed solution in light of the aims of TransmiT.

We currently expect to be in a position to form a view by late May 2011 on whether it is appropriate for us to consult on initiating a SCR to develop an enduring user commitment solution as, by that stage, the details of NGET's proposal are likely to be more developed. We would welcome views on what the appropriate triggers for a SCR may be.

Timely Connections

Responses to our timely connections consultation

Our December 2010 consultation invited views on what 'timely connection' should mean in the context of the new Connect and Manage regime and what, if any, regulatory and/or commercial changes may be appropriate to facilitate timely connections.

We received 11 responses to that consultation. All responses are available on our website⁸. A summary of responses is set out in annex 1 to this letter. Some key points raised by respondents include:

- There was broad support for arrangements that could deliver connection dates that align with the individual needs of connectees. But several respondents raised concerns about the ability to achieve this through incentive and commercial mechanisms, some considering these could give rise to perverse behaviour and have adverse impacts on consumers.
- Some considered that licence obligations already exist⁹ and so TOs should not benefit from a task that they are obligated to do under licence.
- There was some support for compensation for late delivery in certain circumstances. But there was no overall agreement on how any compensation arrangements would work in practice.
- There was some opposition to the development of potential output measures for connection based on "average" or fixed delivery timescales. Many respondents considered that each connection is different and should be decided on its own merits.

A connections output

There is a clear interaction between our work in Project TransmiT and RIIO-T1 on connections. RIIO-T1 is the first transmission price control review to reflect the new regulatory framework resulting from our RPI-X@20 review¹⁰.

An important part of the RIIO-T1 price control is determining customer-focused outputs. This includes outputs on timely connections. We are publishing our RIIO-T1 Strategy Decision documents at the end of March. Taking into account responses to the timely connections consultation and further work with industry, this will set out our decision on

⁸ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=77&refer=Networks/Trans/PT>

⁹ For example, standard licence conditions C8 and D4A in the electricity transmission licence: http://epr.ofgem.gov.uk/document_fetch.php?documentid=15184

¹⁰ More information on RIIO (Revenue = Incentives+Innovation+Outputs) is available on our website: <http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/Pages/RIIO-T1.aspx>

this output and any associated incentives. It is not clear at this stage whether additional commercial changes are needed to support a potential incentives mechanism, particularly as the enduring Connect and Manage regime is still bedding down.

Proposed reporting requirement

We do not think that we have sufficient evidence to demonstrate that the current approach has led to excessive costs or unreasonable delays to connecting. However, we do think that there is value in examining the contractual framework to investigate further if there is any scope to introduce some form of compensation arrangement. We also think that the general efficiency of the process around connection offers could be improved, e.g. the current application fees that potential users are charged may not send the right signals and could be reviewed, and there may be scope for the TOs to further improve dialogue with potential connectees.

We therefore propose to introduce a new reporting requirement on TOs to gather further information on the issues that TOs face facilitating the timely delivery of new connections to the electricity network and the potential changes required to develop arrangements that align with the individual needs of connectees. We think this is likely to be an effective way of gathering information over a longer period of time (e.g. 2011/12 financial year), to better inform our views on whether licence and/or commercial changes may be appropriate. We would seek information on, for example, timing issues raised by TOs and generators, and the process of mitigating potential risks and issues. Subject to responses to this consultation, we expect to initiate a further consultation on this in summer 2011.

We would expect to identify any potential changes we find that may be required to support timely connections through this new reporting requirement in summer 2012.

We would welcome views on our proposal to develop a new TO licence reporting obligation to gather further information in support of arrangements to facilitate timely connections.

Next steps


We welcome responses on the connections issues discussed in this letter by **3 May 2011**. All responses will be placed on our website unless marked as confidential. Please email your response to Project.TransmiT@ofgem.gov.uk.

In particular, we would welcome respondents' views on:

- the high-level principles we have identified against which we consider enduring user commitment arrangements should be developed, and if there other relevant principles
- the high-level user commitment CUSC modification proposal (CMP192) as it currently stands, and whether there are areas where it may need to be further developed
- the appropriate triggers for a potential SCR on user commitment
- our proposal to develop a new TO licence reporting obligation to gather further information in support of arrangements to facilitate timely connections.

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

Yours faithfully

A handwritten signature in black ink, appearing to read 'H Nixon', is centered on a light-colored rectangular background.

Hannah Nixon
Partner, Transmission

Annex 1: Summary of responses to December 2010 consultation on timely connections

Our December 2010 open letter consultation invited views on:

- what 'timely connection' to the electricity transmission network should mean
- the ability of the current commercial framework and incentive arrangements to meet these requirements, and
- potential changes to accommodate this.

We received 11 responses. All responses are available on our website¹¹.

Overall, there was broad agreement that the main features of 'timely connection' in relation to new generation projects is the ability to facilitate the earliest connection date that aligns with the individual needs of each connection. There was also an acknowledgement that the current connection process does not provide a firm connection date or compensation in the event that TOs experience delays in the delivery of connections. However, the majority of respondents raised practical concerns about the ability to achieve these aims through commercial and incentive measures that would avoid perverse outcomes for generators and, ultimately, consumers.

Some points raised include the following:

- Some respondents considered that the current licence arrangements are robust and there is no need to introduce change to encourage timely connection.
- Some respondents considered that TOs could be incentivised to deliver new connections "on time" aligned with the developers' needs. These respondents stressed that a key factor is facilitating dialogue during the offer stage is key to ensuring an optimal achievable date that will take a realistic view of the consent, construction and commissioning process and remain firm once agreed to avoid costly changes.
- Some respondents considered that the main reason for connection delays is planning consent, and these delays are not within the control of the TOs.
- Some respondents considered that the development of fixed incentives based on a defined date for enabling works could disrupt the degree of flexibility in the current connection arrangements and may put perverse incentives on SO/TO to provide a later offer date to reduce penalties/increase rewards.
- A number of respondents called for the connection process to take into account key milestones for development with associated financial liabilities.
- Several respondents considered that there should be compensation for late delivery (some suggesting steepening penalties for longer delays), when the delivery of the connection is within the TOs control. One respondent considered that exposure to significant compensation costs could introduce a significant cash flow risk. There were mixed views on the form and source of the funding arrangements for providing compensation.
- Respondents that supported some form of change also called for the provision of connection to be managed more efficiently and transparently. One respondent commented that there is currently limited transparency of the TOs activity and decision making.

¹¹<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=77&refer=Networks/Trans/PT>

- Two respondents commented on a potential connections incentive to support the UK's 2020 Renewable Targets based on performance against an agreed programme of connections. Under this model, the reward/penalty would be based on the carbon benefit/penalty for a MWh saved/incurred, and have a cap/collar to minimise risk associated with consenting difficulties outside the control of the TO.