



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: **73/11**
Email: Project.TransmiT@ofgem.gov.uk

Date: 27 May 2011

Dear colleague

Project TransmiT: approach to electricity transmission charging work

Project TransmiT is Ofgem's independent and open review of transmission charging and associated connection arrangements. The aim of Project 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 open letter¹, electricity connections issues (such as timely connections and user commitment) and electricity transmission charging are the immediate priority for Project TransmiT.

This letter sets out the approach that we intend to adopt to our work on electricity transmission charging under TransmiT. It explains how we intend to take forward our assessment of the broad range of options which are emerging from work by our academic advisors, dialogue with stakeholders and responses to our call for evidence, interactions with our work on network constraints, and participation in discussions in Europe.

In particular, it sets out that our charging work under Project TransmiT will focus specifically on the charging arrangements that seek to recover the costs of providing electricity transmission assets, i.e. Transmission Network Use of System (TNUoS) charging. We consider that this work should be progressed through a Significant Code Review (SCR)², and we set out our views for consultation on the need, scope and scale of an SCR. This is in line with the original scope of TransmiT, which is seeking to address issues that are an immediate priority, and should enable any appropriate changes to be introduced in the short term. We intend to develop and assess the options in a transparent and open way with National Grid Electricity Transmission plc (NGET), industry and stakeholders more widely over the coming months. If appropriate, we aim to implement any change to TNUoS in time for the next charging year, i.e. from April 2012. However, we recognise that this is an ambitious and challenging timetable. We therefore do not rule out the possibility of implementing appropriate changes at a later date.

Our work to date has also identified options that would require more fundamental change to the electricity transmission charging and wholesale market arrangements. These will not be

¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=80&refer=Networks/Trans/PT>

² An SCR is a holistic review of a code based issue, and can, if appropriate, result in changes being brought forward to more than one code. In this case, our initial focus will be on potential Connection and Use of System Code (CUSC) changes related to TNUoS. However, we are not ruling out widening the scope, if the need is identified as the SCR progresses, to cover other potentially related code changes.

included within the scope of Project TransmiT. Such options may have benefits for consumers and may come to the fore as a result of developments in Europe. We will continue to consider the consequences of European developments for the arrangements in Great Britain (GB) and whether or not these developments imply the need for reform of the GB market.

Our work programme on electricity connections under TransmiT is unchanged. Our March 2011 consultation³ on connections issues has now closed. We are considering responses received and will set out next steps in due course.

We would welcome views on our proposal to launch an SCR on electricity transmission charging (TNUoS) to take forward our charging work under Project TransmiT. Responses should be emailed to Project.TransmiT@ofgem.gov.uk by 24 June 2011⁴.

Background

We launched Project TransmiT in September 2010 by issuing a call for evidence⁵. We published an open letter in January 2011⁶, which confirmed the initial view set out in our call for evidence, i.e. that electricity connection issues and electricity transmission charging should be the immediate priority for Project TransmiT. We set out that we would “fast track” our work on connections (noting we had already issued a consultation on timely connections⁷ and noting the ongoing work to deliver interim and enduring user commitment arrangements⁸), and that separately we expected to consult on charging options in May 2011 (including, if appropriate, on whether to launch an SCR).

In March 2011 we held an industry roundtable event to discuss some of the reports produced by the teams of academics we had appointed⁹. Following the roundtable event, we also published in March 2011 the academics’ draft reports¹⁰, together with an update letter on our work on charging¹¹. Our update letter noted that from the work carried out by our academic advisors, dialogue with stakeholders and responses to our call for evidence, interactions with our work on network constraints, and participation in discussions in Europe, a spectrum of options is emerging. The letter noted that the range of options reflects the divergent views on the importance of cost reflectivity and about the ability of the current arrangements to help deliver a balanced, sustainable and diverse generation mix.

³ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=92&refer=Networks/Trans/PT>

⁴ It is Ofgem’s usual practice, whenever possible and appropriate, to consult with parties for a period of six weeks. In this instance we consider that a four week consultation period is appropriate. We have already signalled that we may launch an SCR to proceed with this work and asked for initial views (<http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/SCRwayforward.pdf> and http://www.ofgem.gov.uk/Networks/Trans/PT/Documents1/110125_TransmiT_Scope_Letter_Final.pdf). Subject to this consultation, we consider that it is important to launch the SCR in a timely manner to facilitate, if appropriate, implementing changes as soon as possible and potentially by April 2012.

⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/PT>

⁶ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=80&refer=Networks/Trans/PT>

⁷ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=77&refer=Networks/Trans/PT>

⁸ NGET has raised CUSC amendment proposal 192 (<http://www.nationalgrid.com/NR/rdonlyres/D2D6F81D-7C3E-4049-8429-817E6A5DA657/45775/CMP192EnduringUserCommitmentv1.pdf>). The user commitment issues being considered under CMP192 are not currently within scope of the proposed SCR on charging under TransmiT. We have not yet taken a decision on whether an SCR may be appropriate on user commitment.

⁹ We set out in our December 2010 update letter on TransmiT the terms of reference for the academics we had appointed (http://www.ofgem.gov.uk/Networks/Trans/PT/Documents1/TransmiT_Update_Dec2010.pdf). We set out in our March 2011 charging update letter (see link in footnote 12) that we had appointed further teams of academics: to consider charging issues from a renewable perspective and to peer review the work of the academics.

¹⁰ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=14&refer=Networks/Trans/PT/WF>

¹¹ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=93&refer=Networks/Trans/PT>

The March 2011 update letter also set out that the emerging options range from the adoption of a non-locational transmission charging model that spreads cost across all users through a uniform charge (a “postalised” approach), through improving the current long-term locational signal in transmission asset charging (e.g. to reflect better the usage pattern of generators), to an approach which would seek to improve short-term locational signals in transmission costs (either to supplement or to replace the long-term locational signals).

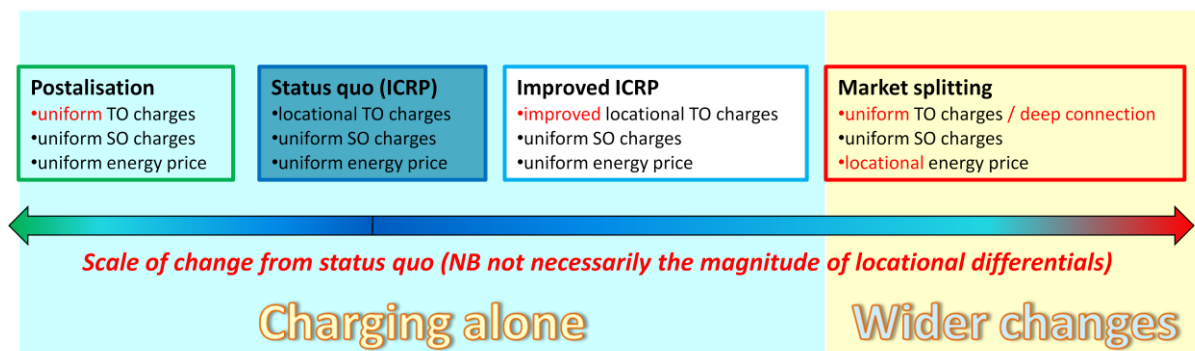
We have published alongside this letter the final versions of the reports that our teams of academic advisors have produced¹².

Emerging options

The emerging options for charging (see figure 1 below) fall into two broad groups:

- Options that may imply wider change than to just the current electricity transmission charging arrangements, including so called ‘market splitting’ options, which would involve changes to the current GB trading arrangements.
- Options to change transmission charging (TNUoS) alone, i.e. changes limited to the electricity transmission charging arrangements (not impacting trading arrangements).

Figure 1: Spectrum of emerging options



Options that imply wider change

Two of the four teams of academics we appointed support options that could involve changes that impact more widely than on transmission charging alone. Their reports favour ‘market splitting’ approaches, which amongst other things would introduce a locational element to wholesale energy prices. Depending on the detail of the design, such options would, to varying degrees, impact the current GB electricity trading arrangements.

At a European level, the debate for greater integration of electricity markets is already focused on market splitting approaches. In due course, options for more fundamental change may come to the fore as a result of European developments.

We are already involved in discussions at a European level. We will continue the work we are doing to understand the impacts of such approaches for GB, to ensure we play a role in helping to shape the direction of travel within Europe. In parallel with our work on electricity transmission charging under TransmiT, we will continue to consider the consequences of European developments for the arrangements in GB and whether or not these developments imply the need for reform of the GB market.

¹² <http://www.ofgem.gov.uk/Networks/Trans/PT/WF/Pages/WebForum.aspx>

Options to change transmission charging (TNUoS) alone

The other emerging options would require changes limited to the existing transmission charging arrangements, in particular changes to the arrangements that seek to recover the costs of providing transmission assets, i.e. NGET's current TNUoS charging methodology. Such changes could potentially be implemented in shorter timescales. We consider there is merit in assessing which, if any, of these options, limited to transmission charging alone, could potentially deliver the aims of TransmiT and bring benefits to consumers in the shorter term.

The options for potential TNUoS changes range from:

- **Socialised charging:** A "postalised" or "postage stamp" approach under which the same uniform tariff would apply to all generation users, whatever their type and wherever they are located. (Similarly another set of uniform tariffs would apply to demand users.) The tariff could be based upon generation capacity (MW, for generators) and maximum demand (for consumers), or upon total energy output for generators and consumption for demand users.

to

- **Improved 'Incremental Cost Related Pricing' or 'ICRP':** Under the current ICRP approach upon which TNUoS is based, users are subject to locational signals reflecting their impact on efficient transmission investment. Under TransmiT, we will consider potential improvements to the current TNUoS methodology (which would not necessarily result in an increase or decrease to the current locational TNUoS signal, but could improve the *accuracy* of charges). For example, changes could include (but are not limited to):
 - better reflection of the impact of generators' output pattern, such as intermittency, on the transmission system,
 - representation of new transmission technology, such as HVDC lines, and
 - potential changes to the revenue recovery split between generation and demand (the 'G:D split').

Developing and assessing the options for charging changes under TransmiT

Having reflected on the views expressed by interested parties, we intend that TransmiT will focus on reviewing options for changes to the TNUoS charging arrangements. Options that involve wider changes, for example to the market trading arrangements, will be outside the scope of TransmiT. This is in line with the original scope of the project. It will enable us to consult on charging recommendations broadly in line with the original timetable, so providing greater certainty for the industry. We intend to develop and assess options for change with NGET, industry and stakeholders more widely, over the coming months.

We are initiating detailed modelling work to identify the likely impacts of the different potential options for change. We will take forward this work in an open and transparent way, and make available the outcomes of our modelling work as that work progresses. We will seek input as appropriate from industry to feed into our modelling work, through focused working groups and/or written consultations. For example, we expect to seek input from industry on specific design features and appropriate assumptions to feed into our analysis.

We expect to consult on the outcome of this work, and on which, if any, of the options may best facilitate the objectives of TransmiT, in October 2011. As set out above, in the period leading up to our October 2011 consultation, there will be a number of opportunities for stakeholders to engage and feed into the work we are progressing.

We think that the work we will do over the coming months could identify options for change that could be implemented in 2012. Whilst our aim is for any change identified to be in place from April 2012, we recognise that this timetable is challenging and that there is a possibility that any appropriate change may be implemented at a later date.

Significant Code Review (SCR)

We set out in December 2010¹³ and in our January 2011 letter that we would, if appropriate, consult on whether to launch an SCR to take forward the charging work under Project TransmiT.

Perceived need

In light of the evidence and information available to us through the work we have done so far under Project TransmiT, we consider that there is merit in progressing any TNUoS changes referred to above via an SCR¹⁴. If any changes are identified, these will result in changes to the TNUoS charging methodology contained in the Connection and Use of System Code (CUSC). We consider it is appropriate for us to lead and provide direction to this work to ensure that matters are addressed in a timely and coordinated manner.

The SCR route

The criteria against which Ofgem will decide whether to initiate an SCR are that:

- the solution to the issues raised by the area of work can be given effect wholly or mainly through code changes;
- the Authority considers those issues are **significant** in relation to its principal objective and/or its other statutory duties and functions, or due to obligations arising under EU law, in particular:
 - there is likely to be significant impacts on gas and electricity consumers or competition (based on a qualitative assessment); and/or
 - there is likely to be significant impacts on the environment, sustainable development or security of supply; and
- the area of work is likely to create significant cross-code or code-licence issues.

Any conclusions from the review of TNUoS discussed above could impact on the TNUoS charging methodology contained in the CUSC and could be given effect by a modification of these. This work could involve code and licence issues, given that the current charging arrangements are designed to be consistent with NGET's licence obligations. We also consider that this work is significant in relation to Ofgem's statutory duties, including our duties in relation to consumers and sustainable development.

Proposed scope

Subject to responses to this consultation, the scope of the SCR will focus on potential short-term changes to the current TNUoS arrangements. As set out above, potential changes that we will assess range from a shift away from the current locational charging arrangements (to socialised charging), to potential changes to the current arrangements to improve the accuracy of charges, e.g. better reflecting usage of the network by intermittent generation.

¹³ <http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/SCRwayforward.pdf>

¹⁴ As set out in our SCR guidance document, there are a number of triggers for Ofgem to take into account when considering whether or not to launch an SCR, including a work stream internal to Ofgem. The guidance can be found here: <http://www.ofgem.gov.uk/Licensing/IndCodes/Governance/Pages/Governance.aspx>

Other potentially more fundamental changes, i.e. options that imply wider changes including to the GB trading arrangements, would not be within the scope of the SCR.

Scale and indicative timescale

Subject to responses to this consultation, we propose to launch a SCR in July 2011 and propose that the work referred to above will be taken forward under that process. It is our intention to engage with industry in the coming months, including through focused workshops and written consultation(s), the details of which will be communicated in due course. Following these, we currently expect to issue a consultation in October 2011 on the outcomes of our modelling work and our initial conclusions under the SCR including any initial preferred option. Subject to responses to that consultation, we aim to identify any preferred option(s) and issue our final SCR conclusions, potentially by January 2012.

At that stage, Ofgem would, if appropriate, issue an SCR direction to NGET to raise the appropriate changes to the CUSC¹⁵. We note that the timescales within which we would then be presented with a proposal on which to make a decision would be dependent on the industry process and what, if any, further industry consideration under that process the Panel consider may be required.

If, after considering responses to this consultation, we decide to launch an SCR, we will confirm and elaborate on the expected timetable in our July SCR launch statement.

We would welcome views on whether the review of the options for changes to the TNUoS charging arrangements under TransmiT fulfil the SCR criteria set out above. We would also welcome your views on the need, scope, scale and indicative timescales for the SCR.

Next steps

We are in the process of initiating the detailed modelling work referred to above, and will set out in the coming weeks how we intend to engage with industry on this and what input we will be seeking.

Subject to responses to this consultation, we expect the next step will be to confirm in July 2011 that we plan to initiate an SCR through a formal SCR launch statement. This statement will be published on the Ofgem website and formally issued to the relevant industry code panels.

Responses to this consultation on our proposal to launch an SCR should be emailed to Project.TransmiT@ofgem.gov.uk by 24 June 2011¹⁶.

Please contact Anthony.Mungall@ofgem.gov.uk if you would like to discuss any of the issues in this letter.

Yours sincerely

Hannah Nixon
Partner, Smarter Grids and Governance

¹⁵ And other affected codes if appropriate.

¹⁶ All responses will be placed on Ofgem's website unless marked as confidential. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.