

Modification proposal:	Balancing and Settlement Code (BSC) P278: Treatment of Transmission Losses for Interconnector Users		
Decision:	The Authority ¹ directs that this proposal be made ²		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	1 May 2012	Implementation Date:	29 November 2012 ³

Background to the modification proposal

When transferring power across the transmission system, some of that power is 'lost' in heat conversion in power cables and switchgear. This lost power is known as transmission losses⁴. Cost recovery for transmission losses is dealt with in the Balancing and Settlement Code (BSC). The National Electricity Transmission System (NETS) is linked to other countries through dedicated links called interconnectors⁵. The interconnectors facilitate import of energy into and export of energy out of Great Britain (GB). Under the current BSC arrangements, for each settlement period, transmission losses are allocated to all Balancing Mechanism (BM) Units, including Interconnector BM Units. Adjustments for transmission losses are made via a Transmission Loss Multiplier (TLM).

Under the Third Package⁶ Electricity Regulation⁷ an inter transmission system operator (TSO) compensation (ITC) mechanism is in place which sets out how TSOs are to receive compensation for hosting cross border flows. National Grid Electricity Transmission (NGET) is required to conform to the requirements of the Electricity Regulation. Modification proposal P278 seeks to remove transmission losses from Interconnector BM Units to comply with the Electricity Regulation and to facilitate cross-border trade in order to promote the development of a competitive and secure internal electricity market.

Applicable legislation

The Electricity Regulation sets out the conditions for access to the network for cross-border exchanges in electricity. Article 14 of the Electricity Regulation (Charges for access to networks) requires that ITC payments and receipts are taken into account when setting network charges. The Electricity Regulation applies from 3 March 2011.

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 This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

³ In order to implement the proposal, changes will be required to central BSC systems. Based on the time needed to make these changes the earliest P278 could be implemented is in time for the November 2012 BSC system release. Therefore two possible implementation dates were put to the Authority: 29 November 2012 (November 2012 BSC Systems Release) if ELEXON receives Ofgem's decision on or before 1 May 2012; or 28 February 2013 (February 2013 BSC Systems Release) if ELEXON receives Ofgem's decision after 1 May 2012 but on or before 28 August 2012.

⁴ Transmission losses currently account for about 2% of the electricity transmitted. See Elexon (July 2010) Overview of Transmission Losses, at the following link http://www.elexon.co.uk/wp-content/uploads/2012/01/Transmission_Losses.pdf

⁵ Under the European Third Package legislation, an interconnector is defined as a transmission line. Regulation 714/2009 defines an 'interconnector' as "a transmission line which crosses or spans a border between Member States and which connects the national transmission systems of Member States." As a consequence, in the context of the EU Internal Market in Electricity, interconnector flows are neither classed as production nor consumption, but part of the overall transmission infrastructure facilitating the wider market.

⁶ The term "Third Package" in this letter refers to the Electricity Regulation and to the Electricity Directive.

⁷ Regulation (EC) No 714/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003.

The Third Package has been transposed into GB legislation by the Electricity and Gas (Internal Markets) Regulations 2011 (the Domestic Regulations). The Third Package creates a new regulatory framework and new institutions to integrate national markets and promote the development of a competitive and secure internal market in electricity. The Domestic Regulations have amended the Authority's principal objective under section 3A of the Electricity Act 1989 (the Electricity Act). The Authority's principal objective is to protect the interests of existing and future consumers. The interests of consumers now include their interests in the fulfilment by the Authority, when carrying out its functions as designated regulatory authority for GB, of the objectives set out in the Electricity Directive. These include promoting a competitive, secure and environmentally sustainable internal market in electricity within the Community and eliminating restrictions on trade in electricity between Member States.

NGET's transmission licence has been amended with the addition of a new applicable objective under the BSC arrangements. This is objective (e) *Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency*, which relates to the NGET's compliance with the Electricity Regulation and any legally binding decisions of the Commission and of the Agency for the Cooperation of Energy Regulators as part of its BSC arrangements.

Article 13 of the Electricity Regulation requires TSOs to receive compensation for costs incurred as a result of hosting cross-border flows of electricity. The ITC Regulation⁸ prescribes the parameters related to setting up the ITC Mechanism⁹ for costs associated with hosting cross-border flows and a common regulatory approach to transmission charging. Article 14 of the Electricity Regulation says that the compensation for hosting cross-border flows of electricity on the TSOs' networks shall be paid by the operators of national transmission systems from which cross-border flows originate and the system where these flows end. The ITC Regulation prescribes how TSOs are to receive compensation for the costs of hosting cross-border flows of electricity on their network, including payments in relation to the costs of transmission losses.

Articles 13(2) and 13(3) and Articles 14(1) to (3) and (5) have been transposed into the Electricity Act and are a "relevant requirement" on NGET for the purposes of the Electricity Act. This means that the Authority can enforce any breaches of these requirements on NGET.

The ITC Mechanism is funded by TSOs on whose systems those flows originate or terminate. Applying transmission losses to Interconnector BM Units would be inconsistent with the Electricity Regulation and with the ITC Regulation on hosting cross-border flows.

The relevant provisions are described and summarised in the table shown.

	714/2009	838/2010	Explanation
ITC	Article 13	Article 1	This mechanism is designed to compensate TSOs for the costs they incur as a result of hosting cross-border flows of electricity on their networks
		Annex A of Regulation	The ITC Mechanism is designed to compensate TSOs for the costs of losses incurred on their national

⁸ Commission Regulation (EU) No 838/2010 of 23 September 2010 on laying down guidelines relating to the inter-transmission system operator compensation mechanism and a common regulatory approach to transmission charging.

⁹ Article 13 of the Electricity Regulation requires TSOs to receive compensation for costs incurred as a result of hosting cross-border flows of electricity.

			transmission systems as a result of hosting cross-border flows of electricity. The compensation is intended to include an estimate of what losses would have been incurred in the absence of transits of electricity.
Charges for access to networks	Article 14(3)		Requires charges for network access to take account of payments and receipts resulting from the ITC Mechanism.
	Article 14(4)		Charges for access to networks shall be applied regardless of the countries of destination and, origin, respectively, of the electricity.
	Article 14(5)		There shall be no specific network charge on individual transactions for declared transits of electricity.

Prior, related Authority decisions

In October 2010, we published a related decision on Modification Proposal GB ECM-26 (Review of interconnector charging arrangements) that proposed changes to NGET's Use of System Charging Methodology. In this decision, we agreed with NGET that removing Transmission Network Use of System (TNUoS) charges for interconnector flows would comply with the Electricity Regulation requirements¹⁰.

The modification proposal

NGET raised modification P278 on 30 September 2011. The proposer considers that, because GB participates in the ITC Mechanism (via NGET as the national TSO) GB transmission losses under the BSC should no longer be allocated to Interconnector BM Units.

The modification proposal aims to remove the irregularity of charging interconnector users and the Interconnector Error Administrators (IEAs) for transmission losses even though NGET participates in the ITC Mechanism¹¹. Under P278 a fixed TLM of 1 would apply to Interconnector BM Units, so that the BSC does not adjust their metered volumes for GB transmission losses. The BSC's TLM will be fixed at 1 for all Interconnector BM Units belonging to interconnector users and IEAs.

The proposer believes that P278 better facilitates the achievement of applicable BSC objectives (a), (c) and (e)¹² as highlighted below:

Applicable BSC Objectives	Proposer's Views
(a) <i>The efficient discharge by the</i>	Applying a fixed TLM equal to 1 to

¹⁰ Use of System Charging Methodology Modification Proposal GB ECM-26 for Interconnector asset owners (IOs) to be treated as a separate class of transmission users as distinct from generation or demand and that they are exempt from both TNUoS demand and generation charges to comply with the Electricity Regulation. Ofgem's decision letter can be viewed at National Grid's website: <http://www.nationalgrid.com/NR/rdonlyres/46289F11-D100-4BC8-A791-6DEF891CC047/43450/ECM26decisionletterpublished041010.pdf>

¹¹ NGET passes compensation payments made under the ITC Mechanism (which can be positive or negative) to the users of the NETS (i.e. suppliers and generators) through its TNUoS charges. NGET has amended its Use of System Charging Methodology so that interconnector users no longer pay TNUoS charges.

¹² As set out in Standard Condition C3(3) of NGET's Transmission Licence, see: <http://epr.ofgem.gov.uk/Pages/EPRIInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRIFiles%2fElectricity+Transmission+Full+set+of+standard+licence+conditions+consolidated+as+at+05.03.2012+-+Current+Version.pdf>

<i>Transmission Company of the obligations imposed upon it by the Transmission Licence</i>	Interconnector BM Units will ensure the charges for those parties are compliant with the ITC Regulation and with the Electricity Regulation.
<i>(c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity</i>	The modification proposal would treat Interconnector BM Units consistently with equivalent arrangements in Europe.
<i>(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency</i>	The modification proposal would ensure that the GB arrangements are compliant with ITC scheme, and thereby with Electricity Regulation.

BSC Panel¹³ recommendation

The Final Modification Report (FMR)¹⁴ was considered by the BSC Panel at its meeting on 12 April 2012. The unanimous view of the Panel was that P278 would better facilitate the applicable BSC objectives, and therefore recommends that P278 is approved. The views of the Panel members are set out in the FMR.

The Authority's decision

The Authority has considered the issues raised by the modification proposal and the FMR dated 12 April 2012. The Authority has considered and taken into account the responses to Elexon's¹⁵ consultation which are attached to the FMR¹⁶. The Authority has concluded that:

1. implementation of the modification proposal will better facilitate the achievement of the relevant objectives of the BSC¹⁷; and
2. directing that the modification be made is consistent with the Authority's principal objective and statutory duties¹⁸.

Reasons for the Authority's decision

We consider that the proposed modification will better facilitate BSC objectives (a), (c) and (e), and is neutral with regard to objectives (b) and (d). In the next section we set out the Authority's assessment of P278 against the BSC objectives. These sections contain reference to respondents' views where appropriate.

(a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence

¹³ The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC.

¹⁴ The FMR can be viewed at the following link: <http://www.elexon.co.uk/mod-proposal/p278-treatment-of-transmission-losses-for-interconnector-users/>

¹⁵ The role and powers, functions and responsibilities of Elexon are set out in Section C of the BSC.

¹⁶ BSC modification proposals, modification reports and representations can be viewed on the Elexon website at www.elexon.com

¹⁷ As set out in Standard Condition C3(3) of NGET's Transmission Licence, see:

<http://epr.ofgem.gov.uk/Pages/EPRIInformation.aspx?doc=http%3a%2f%2fepr.ofgem.gov.uk%2fEPRIFiles%2fElectricity+Transmission+Full+set+of+standard+licence+conditions+consolidated+as+at+05.03.2012+-+Current+Version.pdf>

¹⁸ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

The majority view of the Workgroup was that the proposed modification would ensure that GB arrangements for interconnector users are compliant with the ITC Regulation and with the Electricity Regulation and therefore would better facilitate Objective (a).

We consider that the proposed modification would remove the irregularity of charging interconnector users in GB for transmission losses, as this should be dealt with through NGET's participation in the ITC Mechanism. Removing this irregularity would better achieve Objective (a).

(c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity

The majority Workgroup view was that the proposed modification would treat Interconnector BM Units as required by the Electricity Regulation and by the ITC Regulation and therefore promote effective competition in line with objective (c).

A minority view was expressed that although the proposed modification would remove a barrier to cross-border trade, it could be viewed as undue discrimination when considered in the GB context as it would make it easier for Interconnector Users to compete with GB generators and suppliers.

We are of the view that the modification proposal would remove a barrier to cross-border trade and provide a consistent basis upon which all parties compete in the wider European market. Furthermore, we consider that it would reduce the risk of cross-border flows being inefficiently impeded at times when price difference is not sufficient to cover the cost of losses. Reducing this risk would facilitate price convergence and market integration. Therefore, we believe that the proposed modification would better facilitate objective (c).

(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency

The Proposer and the majority of the Workgroup considered that removing transmission losses from Interconnector BM Units would ensure that GB arrangements are compliant with the ITC Mechanism and with the Electricity Regulation. Therefore, it would better facilitate Objective (e).

We recognise that the modification proposal seeks to reflect the requirements of the recently transposed Third Package as it would align the UK treatment of interconnector links with the default position across Europe. Furthermore we note that it would facilitate the implementation of the EU Target Model as it would remove a potential obstacle to cross-border trade and therefore facilitate the development of a single European electricity market. Thus we consider that P278 would better achieve Objective (e).

Decision notice

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority, hereby directs that modification proposal BSC P278: 'Treatment of Transmission Losses for Interconnector Users' be made.

Martin Crouch,
Partner, European Wholesale

Signed on behalf of the Authority and authorised for that purpose.