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Dear Stakeholder,

Consultation on extending the discount for small transmission connected generators set out in Standard Licence Condition C13 beyond 31 March 2013

We are seeking your views on our proposed approach to extend the "small generator discount" which applies to sub-100MW generators connected at 132kV in Scotland and in offshore waters. We consider that this extension is necessary because of our recent Significant Code Review (SCR) conclusions under Project TransmiT[1]. 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.

SLC C13 requires National Grid Electricity Transmission plc (NGET) to discount the use of system charges for "eligible generators"[2] by a designated amount and to recover the revenue shortfall from demand users on a non-locational basis. At present, this condition will expire on 31 March 2013.

Background

In Scotland and in the offshore waters surrounding Great Britain (GB), generation projects directly connected to the National Electricity Transmission System (NETS) at a voltage of 132kV or more are defined as Transmission[3]. In England and Wales, the 132kV network is defined as Distribution.

Embedded benefits for small generators connected to distribution networks

Embedded benefits relate to a mixture of trading and transmission charges for which embedded generators are not liable. In simple terms, because embedded generators are nearer to the point of end-use for electricity, they have historically avoided the charges associated with transmitting power over the transmission system and the costs associated with balancing the transmission system in real time. These avoided costs are embedded benefits.

Under the Transmission Network Use of System (TNUoS) charging rules applied by NGET, small (sub-100MW) generators connected to the distribution networks (embedded generation) are treated as negative demand[4].

[1] Project Transmit – Electricity charging arrangements Significant Code Review conclusions http://www.ofgem.gov.uk/Networks/Trans/PT/Documents1/TransmiT%20SCR%20conclusion%20document.pdf
[2] "Eligible generator" is defined in SLC C13, as attached in Appendix 1 to this letter.
[3] Section 180 of the Energy Act 2004 substituted a new definition of "high voltage line" in the Electricity Act so that an offshore line of 132kV or more is "high voltage".
[4] This approach is based on the principle that embedded licence-exempt parties (i.e. those exempt from the requirement to hold a generation licence under the Electricity Act 1989) are deemed not to be using the electricity transmission system, and so (i) reduces demand-related transmission costs, by offsetting local demand, and (ii) does not cause transmission costs in its own right.

Compared to other generators situated in the same geographical region, sub-100MW embedded generation therefore enjoys two main benefits from a TNUoS charging perspective:

- avoiding the generation TNUoS tariff; and
- receiving the demand TNUoS tariff[5].

In combination, these effects are referred to as TNUoS "embedded benefits".[6]

The Wider TNUoS tariffs[7] for both generation and demand comprise two components - a locational element and a non-locational residual element. The generation and demand locational elements are broadly equal and opposite within a geographical region. This means that the embedded benefits are approximately equal to the sum of the generation and demand tariff residuals.

Features of SLC C13

SLC C13 "Adjustment to use of system charges (small generators)" was introduced to the electricity transmission licence at the implementation of the British Electricity Trading and Transmission Arrangements (BETTA) on 1 April 2005.

The small generator discount is intended to ensure equivalent treatment of small (i.e. sub-100MW) 132kV-connected generators across Great Britain (GB). This is because 132kV is classed as Transmission in Scotland and in offshore waters, but is classed as Distribution in England and Wales. All 132kV connected sub-100MW generation projects are covered by the small generator discount.

We have separately designated[8] the amount of the small generator discount to be 25% of the total (i.e. generation plus demand) residual elements of the TNUoS charges. The effective annual value of the small generator discount within the current charging year (2012-13) equates to a reduction of £6.76/kW. The shortfall in revenue collected from eligible generators is met by all GB demand customers.

At present, this condition will cease to have effect on 31 March 2013. This condition has been extended twice before in response to regulatory developments. For further details see http://www.ofgem.gov.uk/Networks/Trans/Archive/ElecTrans/TADG/Pages/TADG.aspx

The reasons to extend SLC C13

Project TransmiT

On 22 September 2010 we launched 'Project TransmiT', an independent and open review of electricity transmission charging and associated connection arrangements with a view to ensuring 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 customers.[9]

[5] Depending on its meter registration, the output of an embedded generator 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 an embedded generator may be paid directly the demand TNUoS tariff.
[6] Embedded benefits are also available via the charging arrangements associated with the recovery of costs incurred by NGET in balancing the system (BSUoS), transmission losses and other BSC related administrative charges.
[7] The Wider tariff reflects the costs of the infrastructure assets in the deeper transmission infrastructure. 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.
[8] 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/Archive/ElecTrans/BETTA/Publications/Documents1/9824-6405.pdf
[9] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/PT

Based on our assessment of the evidence received, we launched a SCR on the transmission charging issues under Project TransmiT (the TransmiT SCR).[10]

Taking into consideration the responses to our proposals and our further analysis, on 4 May 2012 we published our conclusions on the TransmiT SCR[11]. In that document we said we intended to issue a direction to NGET to make a Connection and Use of System Code (CUSC) amendment proposal to modify the use of system charging methodology.

The terms of the direction were published on 25 May 2012[12]. The direction initiated the normal CUSC governance process, which will involve a further stage of industry-led work and consultation before a final CUSC amendment report is sent to us for decision. We expect this process, if approved, to set a new baseline for the method of calculating TNUoS charges.

NGET letter

NGET wrote to us on 5 March 2012[13] suggesting that it was not practicable or efficient to implement an enduring transmission charging arrangement solution from 1 April 2013, when SLC C13 ceases to have effect.

The reasons stated in support of an extension were -

- Ideally, the enduring process for SLC C13 should be assessed against a stable and enduring transmission charging baseline after taking account of any amendments from the conclusion of Project TransmiT. NGET considers that progressing two interactive CUSC amendments could prove difficult in terms of quantification, assessment and codification, and is concerned that this could present a significant governance risk to both proposals.

- NGET considers that it is not practical to complete parallel development work on an enduring embedded generation charging proposal and CMP 213 (the CUSC proposal triggered by our direction) in time for a 1 April 2013 implementation date given the industry preference for a holistic approach to SLC C13, possibly including some form of exit reform. NGET notes that this level of interaction suggests that development may be best taken forward through a staged process.

- NGET considers that the level of expected alternatives to CMP 213, together with associated Balancing and Settlement Code (BSC) and possibly Distribution Connection Use of System Agreement (DCUSA) consequential changes, would frustrate the robust assessment of all proposals prior to 1 April 2013. This was not envisaged at the time of the previous discussions that led to the licence modification decision to extend the expiry period to March 2013.

- The main parties likely to be materially affected by any proposed change would be sub-100MW embedded generators, parties not normally signatories to the CUSC. NGET considers that there is a need to broaden the normal CUSC process to ensure adequate consultation of any proposals and to have extended consultation periods to facilitate effective engagement. NGET does not think this is practical by 1 April 2013.

In light of the above, NGET considers that it is therefore necessary to examine the options and associated implementation issues for dealing with the cessation of SLC C13 by the 31 March 2013 deadline. It recommends that the expiry provisions of SLC C13 are therefore extended to April 2016.

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[10] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=141&refer=Networks/Trans/PT
[11] See footnote 1.
[12] Direction to NGET in relation to the TransmiT SCR:
http://www.ofgem.gov.uk/NETWORKS/TRANS/PT/Documents1/Final%20SCR%20cover%20letter%2025%20May.pdf
[13] NGET's letter is published as an annex to this letter on our website:
http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/Charging/Documents1/NGET%20letter%20relating%20to%20the%20review%20of%20C13_5-3-12.pdf

Options

Expiry of SLC C13

We consider there are two policy options available to us for dealing with the expiry of SLC C13 at the 31 March 2013 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 2013. 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 2013 (i.e. do nothing).

Option a)(i) 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 embedded benefits, this option does not make any existing problem worse or create new problems.

Option a)(ii) can only have an advantage over options a)(i) or (b) if the alternative designated sum represents an improvement in the cost-reflective treatment of all relevant generators. Given the extent of industry discussion to date, we do not consider that it is practical for a more cost reflective designated sum to be developed before 1 April 2013 or for the associated licence modification process to paragraph 4 of SLC C13 to be completed. We also consider that the technical detail associated with a solution is best developed through the normal CUSC governance process once the outcome of Project TransmiT is known so that it can take into account any new charging baseline.

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 and in offshore waters. However, it would bring back the potentially undue disparity between 132kV-connected sub 100MW generators in Scotland and offshore waters versus those in England and Wales. We do not think it is practical for us to undertake the analysis required to ascertain whether this would be appropriate before April 2013. We also consider that the technical detail associated with any prospective solution to this is best developed through the normal CUSC governance process once Project TransmiT has concluded.

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

Ofgem's proposals

We propose to extend the current expiry date from 31 March 2013 to 31 March 2016. This will mean that the small generator discount will continue to be based on 25 per cent of the total residual TNUoS tariff.

In previous discussions on modifying the text of SLC C13, we have said that we see the licence condition as an interim measure in the absence of an enduring policy response and that further extension of the small generator discount is not a desirable option. This remains our general position. However, we acknowledge the fundamental changes to the electricity charging arrangements being progressed under the banner of Project TransmiT and the impact that this may have on the enduring charging baseline present unique circumstances. Hence, our initial view is that an extension to 31 March 2016 is appropriate as it:

- provides a level of regulatory certainty to all affected parties;
- allows sufficient time for NGET to have developed proposals following the conclusions that may flow from CMP 213;
- gives the industry enough lead time ahead of implementation to establish an enduring transmission charging baseline as quickly as possible.

This extension will allow an enduring embedded generation solution to be developed to replace SLC C13 that can build upon any new transmission charging baseline emanating from CMP 213[14].

We intend to give effect to this change by amending 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 2016.

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 value of the small generator discount shall be set to zero. Effectively, this means that if the CUSC industry process develops an enduring policy solution faster than anticipated, and we approve its implementation ahead of 1 April 2016, we can remove the discount as it will no longer be needed.

In developing an enduring policy response, we expect the industry to consider the appropriate treatment of small generators currently captured by C13 – in particular taking into account cost reflectivity (which might suggest there should be no discount) and promoting competition (which might suggest some form of equal treatment) across GB.

Views invited

We welcome views and comments on any of the issues raised above, but particularly responses to the following questions -

- Is it appropriate to extend the small generator discount in SLC C13?
- Is 31 March 2016 an appropriate time to extend to?
- Do we need to put in place any further measures to avoid further extension of the licence condition beyond 31 March 2016?

We would like to hear the views of any interested parties on the issues raised in this letter. Responses should be made by **5 September 2012** preferably by e-mail to anthony.mungall@ofgem.gov.uk, marked "**Response on small generator discount**", or alternatively by post to Anthony Mungall, Ofgem, 107 West Regent Street, Glasgow, G2 2BA.

Next steps

We intend to make a decision on the policy decision in Autumn 2012. In the event that a licence change is required, we will issue a licence modification consultation under section 11A of the Act in September 2012 stating our intention to continue with the small generator discount. This would lead to a final modification of licence condition changes in Autumn 2012. We understand from NGET that the indicative tariffs to be published in December 2012, in particular the adjustments to use of system charges for small generator discount, will reflect the outcome of this consultation. The final tariffs would be published on or before 1 February 2013 (in accordance with the default notification timescales set out in the CUSC) reflecting the policy intention of our Autumn 2012 document.

[14] Appendix 2 sets out an indicative timetable for the development of an enduring C13 solution.

Yours faithfully,

Andrew Burgess,

Associate Partner, Transmission and Distribution policy

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 2013.

6. 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).

Appendix 2

Rough indicative timetable for the development of an enduring C13 solution

Timeline	Action
~Q1/Q2 2013	• Authority decision on CMP 213 • Raising of embedded generation CUSC modification proposal by NGET
Q2-Q4 2013	• CUSC modification working group process and any consequential changes
Q2 2014	• Authority decision on C13 enduring solution
To April 2016	• Transition period ahead of implementation in Charging Year 2016-17 (including sufficient lead time for industry parties)