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To all interested stakeholders

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Open letter following Ofgem's decision to reject CMP261

Following the recent decision of the Competition and Markets Authority ('**CMA**') to uphold Ofgem's decision to reject Connection and Use of System Code ('**CUSC**') Modification Proposal '**CMP261**', we are publishing this letter to set out Ofgem's views in light of this decision and our ongoing work to review electricity network charging.[1]

In November 2017, the Authority took the decision to reject CMP261.[2] CMP261 was raised to remedy an alleged breach in 2015/16 of the upper limit of the charge range imposed by European Commission Regulation 838/2010 ('**the Regulation**') and sought to provide a rebate to those generators who pay Transmission Network Use of System ('**TNUoS**') Generator charges. Ofgem rejected CMP261 on the basis that there had not been a breach of the upper limit of the charge range in 2015/16.

The Regulation stipulates that average annual transmission charges paid by GB generators must be within the range of €0/MWh to €2.50/MWh. The CMP261 decision rested on the correct interpretation of the Regulation, specifically with reference to the so-called 'connection exclusion' contained in the Regulation for *"charges paid by producers for physical assets required for connection to the system or the upgrade of the connection"*.[3]

In our November 2017 decision on CMP261, we concluded that:

> *""connection charges", as defined by the CUSC, clearly fall within the scope of the connection exclusion in the Regulation. In addition, we take the view that, properly construed, the connection exclusion also covers most, if not all, local charges that pay for local assets required to connect the generator to the MITS. This is on the basis that the latter also amount to "charges paid by producers for physical assets required for connection to the system" within the meaning of the Regulation."*

As a result, when the correct interpretation of the Regulation was applied no rebate was due to generators for 2015/16 and CMP261 was rejected.

[1] References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day-to-day work.
[2] https://www.ofgem.gov.uk/system/files/docs/2017/11/cmp261_decision.pdf.
[3] Three exclusions to the calculation of the annual average transmission charges are contained in Paragraph 2 in part B of the Annex to the Regulation.

Ofgem's decision was challenged by EDF Energy (Thermal Generation) Limited and SSE Generation Limited. On 26 February 2018, the CMA dismissed the appeal and ordered that GEMA's decision to reject CMP261 be upheld.[4]

CMP261 sought to revise the CUSC to introduce a method by which a rebate would be paid to the relevant generators. Therefore, our decision to reject CMP261 did not change the CUSC charging methodology. It should be noted that CMP261 was the first time that we reached a concluded view on the correct interpretation of the connection exclusion. We did not express any concluded view on the correct interpretation through CMP224 (as recognised by the CMA decision).

Implications of the CMP261 decision

As set out above, the charging methodology is unchanged following our decision to reject CMP261. We do not think a change to the CUSC charging methodology is needed as an immediate consequence of the CMP261 decision, as long as the current formulae at section 14.14.5 (v) of the CUSC ensures compliance with the €0 - €2.5/MWh charge range. We think that it makes sense to consider and decide on any changes to the CUSC charging methodology alongside the ongoing review of residual electricity network charging, as discussed below.

Ongoing review of residual electricity network charging – the TCR

In August 2017 we launched a Significant Code Review ('**SCR**') on electricity network residual charges, called the Targeted Charging Review ('**TCR**'). The TCR includes the following aspects:

- Review of residual electricity transmission and distribution charges, which includes the Transmission Demand Residual (**'TDR'**) and Transmission Generation Residual ('**TGR**') charges, as well as distribution scaling charges.
- Keeping 'other embedded benefits'[5] (which are the different arrangements for smaller Embedded Generators ('**EG**') compared to larger generators in respect of TNUoS and Balancing Services Use of System ('**BSUoS**') charges) under review.
- Encouraging industry to bring forward changes to the network charging arrangements for storage operators (outside of the SCR process).

In reaching our decision to keep the 'other embedded benefits' under review, we took account of our decision on CMP 264/265[6], the fact that some of the arrangements that give rise to relative beneficial treatment for smaller EG (ie BSUOS charging) are in many cases offset by arrangements which give rise to relative disbenefits (ie that smaller EG are not exposed to TGR charges). We have reviewed this analysis since making the CMP261 decision, and do not consider that the situation has materially changed. Hence we consider that it remains appropriate to keep the 'other embedded benefits' under review during the TCR rather than bringing forward other changes at this point. We note that the CMP 264/265 decision is currently under judicial review and we would review the scope of the TCR if that legal challenge was successful.

Hence, assuming there are no further significant changes in the comparative network charging arrangements between different types of generators during the TCR, we expect to introduce any new arrangements to the TGR through the TCR. We are planning to set out a minded to decision on potential changes to these arrangements in the autumn and we currently intend for any changes to come into effect from 2020. As with any major decision we take, we will consider implementation timelines (including whether any transitional arrangements are necessary) holistically, as part of the TCR process, taking into account the scale of change, and implications on all parties impacted by the changes.

[4] https://assets.publishing.service.gov.uk/media/5a9045a0e5274a5b849d3984/sse_edf_appeal_order.pdf
[5] Some of these differences now result in benefits to smaller EG and some result in disbenefits.
[6] https://www.ofgem.gov.uk/publications-and-updates/decision-industry-proposals-cmp264-and-cmp265-change-electricity-transmission-charging-arrangements-embedded-generators

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Policy views on residual charges

Through our TCR work to date, we have set out our current view that residual charges should be levied on final demand, rather than intermediate demand or generators. During the engagement with stakeholders to date, we have heard widespread support for this view and have not heard views or evidence that suggest we should change this view. However, we will be undertaking an Impact Assessment to support our final decision on TCR and this will provide further evidence on this matter.

On the basis of this current view, we consider that the Regulation should be interpreted as setting a maximum level of average transmission charges to be levied on generators, rather than a target level. If there were to be a breach of this upper charging limit, we would expect this to be remedied.

Over the past couple of years, we have indicated that negative residual charges are not conducive to the effective functioning of the wholesale market. However, we consider that the current forecast level of these charges are not so substantial to cause significant distortions over the forthcoming period when changes from the TCR will be finalised and implemented.

We will make a final decision on CMP251 in due course.

We are not requesting formal responses to this letter, but any comments on this letter should be sent to TCR@ofgem.gov.uk.

Regards,

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