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for energy consumers

Open letter

To generation developers and others

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Dear Stakeholder,

Open letter about ongoing reviews of charging arrangements

We want to highlight potential future changes to electricity network access and charging arrangements. The aim of this open letter is to ensure all market participants (including investors) are informed of the potential changes, given the impact that they may have on the business case of those looking to make investment decisions.

These changes have potential impacts for a wide range of market participants, in particular for generators. Following on from our publication earlier this month of a consultation on the needs case for a new transmission link to Orkney¹, I particularly note the potential impacts for generators on Orkney and other Scottish islands where transmission links are planned.

Access and forward-looking charging review

Today we are launching a Significant Code Review (SCR) of electricity network access and forward-looking charging arrangements.² The review aims to ensure electricity networks are used efficiently and flexibly, reflecting users' needs and allowing consumers to benefit from new technologies and services while avoiding unnecessary costs on energy bills in general. One of the main drivers for launching a review is to ensure that there is an effective interface between transmission and distribution arrangements. This is becoming more important as distributed-connected entities (ie including generation connected to the distribution network) are increasingly driving flows, and hence potential costs and savings, on the transmission network.

As a result, we are reviewing the applicability of transmission network charging arrangements to distributed generation as part of the SCR. This could result in changes whereby distributed generators would be liable for transmission charges in the same way as transmission generators.³ This could be relevant for costs associated with new transmission network extensions, such as the proposed subsea transmission project to Orkney, or the other Scottish islands. We are also reviewing the charging design of the transmission charging arrangements for demand users. Collectively, any changes resulting from our review of both matters may affect the forward-looking transmission network charges for distribution-connected entities, generally (including onsite generation, storage and demand-side response).

We currently expect to implement any changes in 2022 and 2023.

¹ Orkney transmission project: Consultation on Final Needs Case and Delivery Model, 14 December 2018; [link here](#)

² More information on our review of electricity network access and forward-looking charging arrangements can be found in the [link here](#).

³ Distributed generators with a connection capacity of 100MW or more do pay some Transmission Network Use of System (TNUoS) charges.

We value the views of all stakeholders and our SCR launch letter provides further information on how stakeholders can become involved in the process. We strongly encourage those market participants affected by network charging to read the SCR launch decision published today and engage in this review.

Scope for change under the existing methodology and through industry open governance

As part of our proposed review of forward-looking charges, we do not propose a wide-ranging review of transmission network charges. However, the network charges incurred by transmission-connected generators are still subject to change through industry processes. I summarise below how these arrangements currently work and some aspects of potential change which could affect major network extensions such as the subsea Orkney project.

Generators' forward-looking transmission charges are made up of two components:

- a local locational tariffs, including the local circuit tariff: this reflects the cost of the local assets used to connect generators to the wider transmission network (known as the Main Interconnected Transmission System (MITS)); and
- a wider locational tariff: this represents the cost (or savings) of electricity being added to the transmission system in different geographical zones.

The provisions of the existing transmission charging methodology mean that what constitutes a MITS node and the definition of the transmission generation zones change over time:

- the classification of which assets are considered part of the MITS is updated annually to reflect system changes. Some configurations for the proposed network extensions to the Scottish islands could result in the MITS being extending to them; and
- the transmission generation tariff zones are reviewed at the start of each period covered by our price controls of network companies⁴ and can be reviewed at other times in exceptional circumstances. The zones are designed to ensure that there are no significant differences in network costs within a zone.

If the extension of the transmission system to Orkney (or other Scottish islands) were to lead to the MITS being extended to the island, then this could lead to the creation of a new transmission generation tariff zone. We would expect the Electricity System Operator (ESO) to provide information on any potential changes to transmission generation zones as soon as possible (eg through the Transmission Charging Methodology Forum).⁵

There could be further changes to the transmission charging methodologies that are outlined in the Connection and Use of System Code (CUSC) through open governance. This means that parties can propose changes to the charging methodology that they consider better meet the relevant CUSC objectives (eg to ensure that arrangements remain cost reflective). The ESO also has an obligation to keep the charging methodology under review.

Targeted Charging Review

We are also keen to make sure that all market participants, including generators, not just those on the Scottish islands, are aware of changes that we are consulting on as part of our Targeted Charging Review. We are specifically proposing to change two elements of electricity network charges:⁶

⁴ RIIO-ET1 is due to start in April 2021.

⁵ The Transmission Charging Methodology Forum is established under the CUSC and aims to provide a forum for regular discussion on the development of charging methodologies; more information can be found [here](#).

⁶ 'Targeted charging review: minded to decision and draft impact assessment'; 28 November 2018; [link here](#).

- **Residual charges:** Residual charges are the element of network charges for both transmission and distribution that are designed to ensure network costs are fully recovered. Unlike forward-looking charges, these are not designed to send signals to network users. We are proposing to reform residual charges to ensure that these charges are allocated fairly now and in the future. We are consulting on two options for recovering residual charges (a fixed charge and an agreed capacity charge, both options recovering the residual from final demand users only). Our preferred option at this stage is a fixed charge.
- **'Embedded Benefits':** 'Embedded Benefits' is the term used to describe the different charging arrangements for small (below 100MW) distribution-connected generators, compared to larger generators. We have been concerned that there has been insufficient evidence of a link between these benefits and the costs of the networks. We approved removal of the biggest 'Embedded Benefit' in 2017 and said we would review the remaining benefits in the Targeted Charging Review. The changes we are consulting on are:
 - The Transmission Generator Residual – The current methodology for transmission residual charging leads to larger generators receiving a fixed rebate (negative charge). This is a result of a cap on the average level of transmission network charges which generators should pay. We consider there are advantages to taking residual charges off generators and for final demand users only to face residual charges, and this will also remove the current distortion where small distributed generators do not receive this rebate (negative charge), and are now at a disadvantage to larger generators. We propose to set the transmission generation residual to zero.
 - Balancing service charges: payments – Unlike larger generators, small distributed generators can be paid for helping suppliers reduce their contribution to the costs of balancing the system. We are proposing to change the methodology that leads to this payment, resulting in its effective removal.
 - Balancing service charges: avoided charges – Small distributed generators also do not pay the generation balancing service charges, which all other generators connected to transmission and distribution networks are currently required to pay. We are proposing to apply balancing service charges to small distributed generation.
 - Small Generator Discount – Certain generators in Scotland also receive a reduced transmission network charge known as the Small Generator Discount. This was introduced to create a level playing field across Great Britain following the integration of the Scottish wholesale market with that in England and Wales in 2005. We are proposing to extend the expiry date of this discount to 31 March 2021, to align with the proposed timing of other reforms. Our consultation on the Small Generator Discount closes on 4 January 2019.

These changes could affect all generators, not just those in the Scottish islands. The consultation closes on 4 February 2019. If you have views about any of proposals, we would encourage you to respond. We also welcome attendance at the Charging Futures Forum⁷ being held on 15 January 2019 to help inform consultation responses.

Balancing service changes

We have also asked the ESO to launch a task force to provide analysis to support decisions on the future direction of balancing service charges (also known as Balancing Service Use of System (BSUoS) charges).⁸ This could affect the future balancing service charges that are incurred by all generators, not just those on the Scottish islands. In particular, it will examine the potential and feasibility for some elements of balancing service charges being made more cost-reflective and hence provide stronger forward-looking signals. The task force is due to report its findings in spring 2019. Depending on the outcome of the work,

⁷ <http://www.chargingfutures.com/>

⁸ 'Review of balancing service charges', 28 November 2018; [link here](#).

we expect that the ESO or other parties could take forward appropriate modification proposals to effect the changes identified under the usual code governance process.

Taking this work forward

In our electricity network access and forward-looking charges SCR launch letter, our minded to decision on the Targeted Charging Review and our open letter on balancing service charges we provide further information on how to get involved with these specific reviews. Through our own work and our work with the Charging Delivery Body (CDB)⁹, we will seek to ensure that network access and charging reform remains coordinated. If you are interested in being kept up-to-date with our work on network access and charging reform, we would encourage you to sign up to the Charging Futures distribution list¹⁰ or attend the Charging Futures Forum.¹¹

We recommend that, in making any investment decisions, developers are mindful of the possibility that current network access and charging arrangements may change in the future.

Yours sincerely



Andrew Burgess

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⁹ <http://www.chargingfutures.com/whats-happening/charging-delivery-body/charging-delivery-body-home-page/>

¹⁰ <http://www.chargingfutures.com/sign-up/>

¹¹ <http://www.chargingfutures.com/whats-happening/charging-futures-forum/charging-futures-forum-home-page/>