



Andrew Self  
Head of Network Charging  
The Office of Gas and Electricity Markets  
10 South Colonnade  
Canary Wharf  
London  
E14 4PU

**Uniper UK Limited**  
Compton House  
2300 The Crescent  
Birmingham Business Park  
Birmingham B37 7YE  
www.uniper.energy

**Paul Jones**  
T 44 77 71-97 57 82  
paul.jones@uniper.energy

Registered in  
England and Wales  
Company No 2796628

Registered Office:  
Compton House  
2300 The Crescent  
Birmingham Business Park  
Birmingham B37 7YE

**Statutory consultation on the proposal to modify Standard Licence Condition C13 (Adjustment to use of system charges (small generators)) of the electricity transmission licence**

4 January, 2019

Dear Andrew,

Thank you for the opportunity to respond to the above consultation. Uniper does not support the extension of the above discount and feels that it would contradict the principles under which it was first introduced.

As you know, the small generator discount (SGD) was originally introduced in April 2005 on the premise that small generators connected to the transmission network at 132kV were being treated unfairly compared with other generators connected at 132kV on distribution networks. This is because the distribution connected generators were exposed to embedded benefits whereas those connected to the transmission system paid generation TNUoS charges.

Whilst we agree that the embedded benefit needed to be removed, we also feel that the small generator discount has always resulted in undue discrimination in favour of those who receive it, compared with other generators connected to the transmission network. The voltage at which a generator is connected or the generator's size in itself should not be relevant to which charging regime it is exposed to. This should be down to whether that generator is connected to transmission or distribution assets as defined in UK legislation. The fact that similar voltages are used on both networks is immaterial. However, we accept that this perspective is not shared by Ofgem as the discount has been in effect for just under fourteen years.

The SGD was created as a result of a number of consultation documents issued by Ofgem and the Department of Trade and Industry (DTI) in 2003 and 2004, concerning how to treat small generators in the new British Electricity Trading and Transmission Arrangements. One key document from November 2003<sup>1</sup> stated a number of important perspectives on the thinking behind the proposal:

- The 2003 document indicated the SGD was introduced due to a concern about TNUoS charging alone, stating "*The specific area of concern relates to the*

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<sup>1</sup> Small Generator Issues under BETTA - An Ofgem/DTI Consultation Document (November 2003)

*TNUoS benefit of a distribution connected generator being able to net off demand with a local supplier*<sup>2</sup>. Furthermore, the consultation says *“For the avoidance of doubt it is Ofgem/DTI’s view that small, transmission connected generators should be liable for all other transmission-related charges on the same basis as other transmission-connected generators”*<sup>3</sup>.

- Ofgem and the Government concluded that this was problematic because *“the operation of the TNUoS embedded benefit confers a benefit to small distribution-connected generation relative to small transmission-connected generation, and that this difference in treatment is not proportionate”*<sup>4</sup>.
- The level of the embedded benefit was noted as being equal to the sum of the residual charges for generation and demand respectively<sup>5</sup>. This was because the small embedded generator directly avoided the generation residual and allowed suppliers to avoid the demand residual, whilst the two locational tariffs cancelled out<sup>6</sup>.

In order to address the above issues, it was concluded that two strands of work should be undertaken:

1. Over the longer term Ofgem and DTI concluded that work should be undertaken to *“ensure greater consistency of transmission charges and benefits between transmission and distribution connected generators”*<sup>7</sup>.
2. In the meantime, Ofgem and DTI believed that it would be appropriate to introduce *“an interim measure to ensure that small generators connected at 132kV in Scotland are not disadvantaged in the short term relative to other parties within the class of small generators”*<sup>8</sup>.

In Ofgem’s final decision document in February 2005 to introduce the SGD<sup>9</sup>, it was further clarified that the discount would be set at 25% of the embedded benefit (ie 25% of the combined generation and demand residuals). The document also explained that the discount was for an interim period of three years and therefore set to expire in April 2008.

Apart from our view expressed above that the SGD actually introduces discriminatory treatment, we believe that the latest proposed extension contradicts Ofgem’s rationale for why and how it was set. This is for two main reasons which we explain below.

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<sup>2</sup> Paragraph 8.22

<sup>3</sup> Paragraph 8.32

<sup>4</sup> Paragraph 8.25

<sup>5</sup> Paragraph 8.32

<sup>6</sup> This is further explained in Ofgem’s document: BETTA “minded to” statement on the interim discount for small transmission connected generators and impact assessment (17 December 2004)

<sup>7</sup> Paragraph 8.27

<sup>8</sup> Paragraph 8.28

<sup>9</sup> Interim discount for small transmission connected generators – decision letter (25 February 2005)



## **1. The rationale for the discount no longer exists**

As noted above, the original rationale for the SGD was as an interim measure until enduring TNUoS charging/benefit arrangements were developed and introduced for small embedded generators. The SGD was intended to be in place for three years with the possibility of an extension for a fourth year. It has subsequently been extended four times. This latest proposal would result in a fifth extension and would mean the total duration of the arrangements would be sixteen years.

For previous extensions it could be argued that this was justified, as enduring arrangements to address the TNUoS embedded benefits issue had not been developed. However, in April 2018, new TNUoS charging arrangements were introduced to address this issue as a result of CUSC modification proposals CMP264 and CMP265. Therefore, the rationale for the discount no longer exists, as the TNUoS embedded benefit issue has in the main been addressed. The TCR is continuing to look at how generation installed on customer sites “behind the meter” could be more appropriately charged. However, this is a lower priority issue at present and should not be a reason for retaining the SGD, particularly in light of the significant reduction in embedded benefit experienced by the large amount of plant affected by the new arrangements under CMP264 and CMP265.

## **2. The “designated sum” under licence condition C13 is now out of date**

Transmission licence condition C13, which sets out the basis and implementation of the SGD, refers to a “designated sum” at which the level of discount is set. As mentioned above, this was originally set to 25% of the level of the TNUoS embedded benefit, which at that time was the sum of the generation and demand residual charges. Since the implementation of CMP264/5, the level of embedded benefit has reduced. The avoided generation residual is still part of the benefit, but the demand residual is no longer fully avoided. Instead, a new embedded benefit has been introduced, which represents the sum of average GSP avoided costs (AGIC) plus a phased amount of the demand residual.

Given that the AGIC is a legitimate avoided cost, then it should not be considered part of the calculation of the discount calculation. Therefore, the correct “designated sum” should be calculated in relation to the sum of the generation residual and the phased demand residual. Therefore, we believe that the designated sum has already been set at an inappropriate level in respect of the current charging year.

Figure 1 below illustrates the differences using actual and forecast data from National Grid’s September TNUoS forecast. It shows the level of embedded benefit and compares it with two measures of designated sum. The first of these is the existing designated sum which is calculated as 25% of the sum of the demand and generation residuals. The second of these we have termed the “correct” designated sum which is calculated as 25% of the sum of the generation residual and phased demand residual.

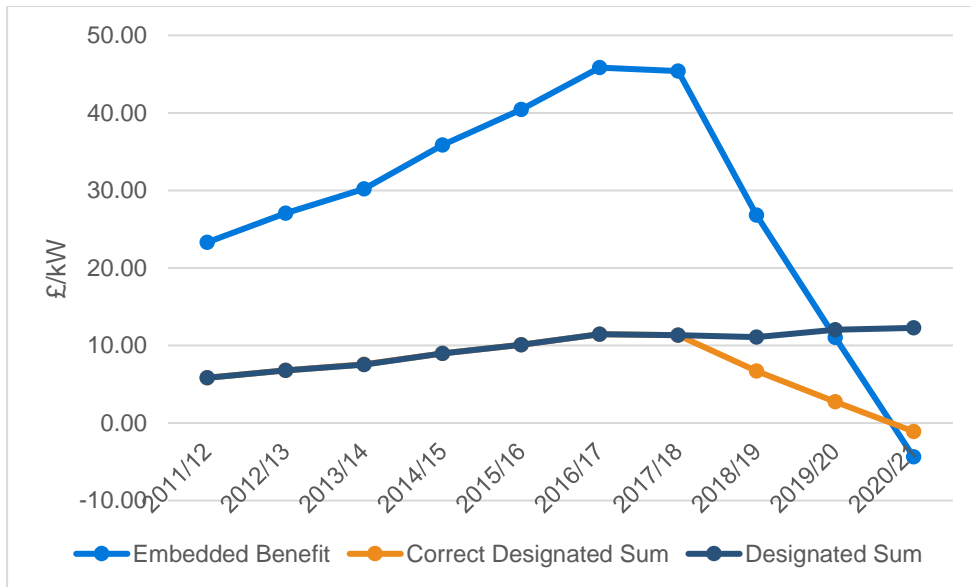


Figure 1: Embedded benefits versus designated sums

Figure 1 shows that the current level of designated sum is already higher than it should be for this year and, if the proposal is implemented as currently planned, will be close to the full amount of embedded benefit for 2019/20. The figure also shows that the SGD will be much higher than the full embedded benefit for 2020/21. Indeed, the graph shows that the average embedded benefit in 2020/21 is in fact slightly negative, as the level of phased residual reduces to zero and only the negative transmission residual remains. Of course, floor arrangements in the CMP264/5 solution prevents this actually being the case when combined with the locational charge, but it illustrates that the current designated sum would significantly overstate the amount of discount respective to the embedded benefit which small embedded generators will actually receive.

**Other embedded benefits**

We note that Ofgem’s minded to positions on the current charging reviews refer to addressing the remaining embedded benefits that exist, particularly related to the levying of Balancing Services Use of System (BSUoS) charges. Whilst we agree that the current BSUoS charging regime provides a significant embedded benefit, and also distorts cross border trade, we do not believe that the SGD should be used to adjust for it. As we note above, the original rationale for the SGD was related to the TNUoS embedded benefit. Ofgem and DTI at the time concluded it was appropriate for small generators connected to the transmission network to be exposed to other charges such as BSUoS. Of course, even if Ofgem’s view on this has changed, it would be inappropriate to use a mechanism based on another charge such as TNUoS to provide relief to small transmission connected generators.



## Conclusions

In summary, our reasons for believing that the SGD should not be extended for a fifth time are:

- The concept of the SGD actually introduces undue discrimination between similar parties connected to different parts of the transmission network. This is reason in itself for not continuing it.
- Nevertheless, Ofgem's and DTI's conditions for its removal have been met following the implementation of CMP264/5. Therefore, arguably the discount should already have been removed with effect from April 2018.
- Notwithstanding the above, the current level of designated sum has been set to an incorrect level following the implementation of CMP264/5. Therefore, even if Ofgem were to proceed with extending the SGD, the designated sum should be redefined by Ofgem in accordance with condition C13 of the transmission licence.

We note that National Grid's latest forecast indicates that around £33m will be distributed under the SGD next year if it is continued. This represents a significant proportion compared with the £400m which is expected to be recovered from generators as a whole in TNUoS charges.

I hope the above comments prove helpful. Please do contact me should you wish to discuss this further.

Yours sincerely

Paul Jones  
Senior Regulation Manager  
Uniper UK Limited