TRANSMISSION CHARGING AND THE GB WHOLESALE ELECTRICITY MARKET

Ofgem/DTI conclusion on Part 1: Changes to transmission licences to implement GB transmission charging under BETTA

DECEMBER 2003
The DTI drives our ambition of ‘prosperity for all’ by working to create the best environment for business success in the UK. We help people and companies become more productive by promoting enterprise, innovation and creativity.

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Summary

In August 2003 Ofgem/DTI published a consultation document in two parts on the issue of transmission charging and the GB wholesale electricity market. Part 1 concerned proposed changes to the regulatory framework, and in particular transmission licenses, to implement the transmission charging element of the British Electricity Trading and Transmission Arrangements ("BETTA") package of reforms. This document presents Ofgem/DTI’s conclusions in respect of Part 1 of the August consultation.

Part 1 of the August document set out Ofgem/DTI’s view that the GB system operator should be the party responsible for setting transmission charges across Great Britain ("GB"). In order to do so it was proposed that the GB system operator would be responsible for developing and maintaining the charging methodologies and that the regulatory basis of these arrangements should be NGC’s existing Standard Licence Conditions in England and Wales. From a process perspective Ofgem/DTI proposed that the initial GB system operator should develop its charging methodology through consultation and the basis of that consultation should be the charging arrangements in place in England and Wales. The August document set out a proposed process and timetable for that consultation. It also proposed that the GB system operator should recover the total costs of the transmission system on GB basis.

In Part 2 of the August consultation DTI sought views on the related issue of whether licence obligations on the GB system operator in respect of charging should be augmented to provide for lower charges for renewable generators, in the light of Government targets for growth in renewables and the prevailing packing of support for such generators. DTI intend to publish its conclusion shortly.

Ofgem/DTI’s conclusions in respect of Part 1, as set out in this document, confirm the view set out in the August document that the broad framework and process set for establishing a GB transmission charging regime are appropriate. In reaching this conclusion Ofgem/DTI has considered all responses to the August 2003 document.
Respondents to Part 1 of the August document were largely supportive of the principles. In particular, it was widely agreed that the current licence driven approach was an appropriate basis for developing GB transmission charging arrangements and that the GB system operator being independent of generation and supply interests was the most part to operate the contractual interface between users and the transmission sector.

The majority of respondents also agreed that England and Wales arrangements, including the existing arrangements for the liability for payment of transmission charges, should be used as the basis for consultation on GB arrangements. They noted that this would be the least disruptive approach, and would provide a solid basis with which the market is familiar.

However, the responses also highlighted a number of issues that require to be addressed either thorough further consultation by the initial GB system operator on the detail of GB charging arrangements or in other areas on the BETTA project. The most significant of these, which was highlighted in the August document, concerned the requirement for additional non-discrimination provisions. In light of comments Ofgem/DTI agree that the interaction between the GB system operator and non-affiliated TOs could create the potential for new forms of discrimination and thus on the need for additional non-discrimination provisions to address this. Ofgem/DTI intend to conclude on the form of additional non-discrimination provisions in the forthcoming paper on Transmission Licence Conditions under BETTA. This is due to be published in December.

Among the other issues that were raised included the GB system operator’s requirement for information from the non-affiliated TOs in order to develop a GB charging methodology. On this issue Ofgem/DTI recognise that there will be ongoing information requirements and that the provision for the sharing of information should be addressed through the SO-TO Code.

Following the publication of this paper and in light of the recent publication of a paper of small generator issues, NGC as initial GB system
operator will initiate a consultation on GB transmission charging methodologies. NGC’s consultation will continue into the following charging year and will culminate with the submission of proposals to Ofgem for approval around October 2004. The charging methodology approved by Ofgem will apply from BETTA Go-live (anticipated to be 1 April 2005).
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1. Rationale


1.2. On 30 January 2003, the DTI published the draft Electricity (Trading and Transmission) Bill (“the E(TT) Bill”)³ together with a Regulatory Impact Assessment (“RIA”), which explains the purpose and impact of the BETTA reforms and the expected costs and benefits of BETTA⁴.

1.3. These documents set out Ofgem’s view that it was appropriate and timely to implement market based wholesale trading arrangements in Scotland. It also proposed that the most appropriate way of achieving this was through the creation of Great Britain (“GB”) balancing and settlement arrangements, a common GB transmission charging regime and common terms throughout GB for connection to and use of the transmission system (reflecting in part the incorporation of the Scotland-England interconnector into the GB transmission system). In addition, it proposed the creation of a GB system operator, independent of generation and supply interests⁵, responsible, at a minimum, for balancing the GB transmission system.

⁵ Other than for the purposes of balancing the system under BETTA, the activities of generation or supply in GB, or of trading electricity in GB, or the carrying out of any other relevant activity which may conflict with the carrying out of the activities of the GB system operator in an
1.4. The May 2002 report discussed the responses received to the December 2001 consultation, outlined Ofgem/DTI’s preliminary views in light of those responses and set down what Ofgem/DTI considered to be the principal building blocks of BETTA.

1.5. One of those building blocks was the introduction of GB charging methodologies for connection to and use of the transmission system, using arrangements applying in England and Wales as a basis for consultation.

1.6. There are currently three transmission licensees in GB – the National Grid Company (NGC) in England and Wales, SP Transmission Ltd (SPT) in the south of Scotland and Scottish Hydro Electric Transmission Ltd (SHETL) in the north of Scotland. Each is subject to a separate set of licence conditions regulating its activities and produces and maintains its own use of system and connection charging methodologies for its own area.

1.7. In August 2003 Ofgem/DTI published a document (“the August document”) which set out a consultation in two parts on the issue of transmission charging and the GB wholesale market. The first was an Ofgem/DTI consultation on implementing the transmission charging element of the BETTA reforms. The second was a DTI consultation on how a GB transmission charging regime might impact on the Government’s policy objectives for renewables.

1.8. In total Ofgem/DTI received seventeen responses to Part 1 of its August consultation one of which was marked as confidential. The other sixteen responses are available electronically from the Ofgem Research and Information Centre. A list of the non-confidential respondents is set out in Appendix 1.
1.9. This document summarises these responses and in light of them sets out Ofgem/DTI’s conclusions to Part 1 of the August document. It sets out proposals for establishing a GB transmission charging regime and the GB system operator’s responsibilities within that regime. Its conclusions, noting that the DTI’s conclusions in respect of Part II of the August document to be published shortly might augment the regime in respect of charges to renewable generators, address:

- the basis to be used for developing GB charging methodologies
- the form of licence obligations on the GB system operator in this regard
- interactions between the GB system operator and transmission owners (TOs)
- the basis for the recovery of transmission costs
- liability for transmission charges, and
- the process and timetable for introducing GB transmission charging arrangements.
2. Timetable

2.1. This document represents a report on conclusions in respect of the proposed changes to the regulatory framework to create a single GB charging regime.

2.2. In the light of the proposed licence obligations for the GB system operator set out in this paper, Ofgem/DTI envisage that NGC as initial GB system operator\(^7\) will initiate a consultation in December on GB transmission charging methodologies.

2.3. NGC will bring forward further consultations during next year as it develops its proposals for GB charging arrangements in the light of its anticipated licence obligations in respect of charging. Ofgem/DTI expects NGC to undertake a series of workshops and seminars within this framework in order to make the consultation process as transparent and inclusive as possible.

2.4. This process will culminate in the initial GB system operator submitting proposals on GB charging methodologies to Ofgem for approval around October 2004. The charging methodology approved by Ofgem will apply from BETTA Go-live (anticipated to be 1 April 2005).

2.5. The conclusions set out in this paper will provide the basis for progressing licence drafting in relation to transmission charging issues. These issues will initially be addressed in Ofgem/DTI's forthcoming paper on Transmission Licence Conditions under BETTA due to be published in December. It is intended that a

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7 The GB system operator will not be formally appointed (i.e. licensed to carry out the relevant activities) until after commencement of the BETTA legislation. On 17 December 2002 the Minister for Energy and Construction, Mr Brian Wilson, stated in a response to a Parliamentary Question that, the NGC plc’s application for the role of GB system operator should be accepted. - See Hansard, 17 December 2002, Official Report Column 45W5
conclusions paper and final legal text for the transmission licence conditions will be published in March 2004. Licence conditions will then be designated by the Secretary of State after the Energy Bill has been given Royal Assent.
3. Background

3.1. In the December 2001 consultation, Ofgem set out its vision of a model that would enable all consumers in GB to benefit from more competitive wholesale markets. The set of proposed reforms outlined in that paper are collectively known as BETTA.

3.2. On 15 April 2002, the Government announced its intention to bring forward legislation to implement BETTA when Parliamentary time allows\(^8\). On 30 January 2003, the Government published the draft E(TT) Bill for pre-legislative scrutiny by the Trade and Industry Committee. The report of the Trade and Industry Committee was published on 8 April 2003. The DTI’s subsequent response to the report can be found on the Committee’s website\(^9\).

3.3. The August document set out in detail the nature of the legislation as well as the then current progress on Ofgem/DTI consultations and on other relevant related issues. This document provides an update on these areas.

The Energy Bill

3.4. The Queen’s speech on 26 November 2003 stated the Government’s intention to bring forward in the coming session of Parliament a Bill on energy matters. The Energy Bill received its First Reading in the House of Lords on 27 November. The Energy Bill, which including the provisions to facilitate the implementation of BETTA previously included in the draft E(TT) Bill, was published on 28 November.

3.5. The implementation date of 1 April 2005 remains dependent on Royal Assent being received to the Energy Bill by July 2004.

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\(^8\) Hansard, 15 April 2002, Official Report Column 748W
\(^9\) [http://www.parliament.uk/parliamentary_committees/trade_and_industry.cfm](http://www.parliament.uk/parliamentary_committees/trade_and_industry.cfm)
BETTA documents

3.6. A summary of the BETTA documents prior to August can be found in the August document and also on Ofgem’s website\textsuperscript{10}. Since the publication of the August document Ofgem/DTI have published further papers in relation to the Grid Code, SO-TO Code (“STC”), changes to generation, distribution and supply licences and most recently on price control and incentive arrangements.

3.7. On 30 September 2003 Ofgem published the second in a proposed series of three consultations on developing a single Grid Code for GB. This paper concluded on the issues raised in the first consultation on a GB Grid Code in December 2002. The September 2003 paper set out the first draft of the GB Grid Code and invited views on the text. The September 2003 paper noted that a detailed comparison of the two existing Grid Codes, with the identification of further regional differences between the two existing codes that may need to exist at BETTA go-live would be considered in mini-drafting consultations. The first of those mini-consultations on most of the Operating Codes was published on 30 October 2003. Further such consultations are intended on the detail of the Connection Conditions, Balancing Codes, other Operating Codes, the Planning Code and General Conditions.

3.8. On 30 September 2003 Ofgem/DTI published a further paper on changes to the electricity generation, distribution and supply licences under BETTA\textsuperscript{11}. This considered the responses received to

\textsuperscript{10} \url{www.ofgem.gov.uk}

\textsuperscript{11} Changes to electricity generation, distribution and supply licences under BETTA: A second Ofgem/DTI consultation – Ofgem, Sept 03 Consultation document #114/03, Annex #114a/03
the January 2003 consultation on this subject\(^{12}\) and set out further proposals. In the annex to the paper Ofgem/DTI set out draft legal text of changes to licence conditions for consultation.

3.9. A consultation paper on the process for handling disputes under the STC was published by Ofgem/DTI on 9 October 2003\(^{13}\). This was the first of a series of mini-consultations due to be published on the STC following Ofgem’s announcement of its intention to take this approach in its June 2003 consultation on the STC under BETTA\(^{14}\). Respondents' views on these mini-consultations will be taken into account in further development of the detail of the STC.

3.10. On 30 October 2003 Ofgem/DTI published a consultation document on price control and incentive arrangements under BETTA\(^{15}\). This paper is the first in a series of consultations which will lead to Ofgem’s final proposals for the price controls and incentives to apply to the three transmission licensees. It sets out how Ofgem/DTI propose that licence conditions will be developed to ensure that, given the changes in roles of the existing transmission licensees under BETTA, those licensees continue to be appropriately financed and incentivised.

3.11. On 20 November 2003 Ofgem/DTI published a consultation document on small generator issues under BETTA\(^{16}\). This document addressed, among other matters, the issue of transmission charges for small generators who are directly connected to the transmission system. It proposed that an interim measure to reduce transmission

\(^{12}\) Changes to the electricity generation, distribution and supply licences under BETTA: An Ofgem/DTI consultation – Ofgem, Jan 03
\(^{13}\) Process for handling disputes under the SO-TO Code under BETTA – Ofgem/DTI, Oct 2003, #118/03
\(^{14}\) ‘The SO-TO Code under BETTA: Summary of responses and conclusions on Volume 3 and Volume 4 of the December 2002 consultation on the regulatory framework for transmission licensees under BETTA and further consultation on content of the SO-TO Code’ – Ofgem, June 2003 #41/03
\(^{15}\) Price controls and incentives under BETTA – Ofgem/DTI, October 2003 #130/03
\(^{16}\) Smaller generator issues under BETTA – An Ofgem/DTI consultation document – Ofgem/DTI, November 2003 #145/03
charges for small, transmission connected generators was appropriate to ensure that such generators were not unduly disadvantaged under BETTA. Ofgem/DTI intend to publish conclusions on this issue in February 2004.

Other related issues

NGC’s review of charging arrangements in England and Wales

3.12. NGC is obliged under its licence to keep its connection and use of system charging methodologies under review at all times. Where appropriate the company is required to bring forward proposals for change which will in its view result in it better meeting the relevant objectives. The relevant objectives in relation to its charging methodologies are set out in licence condition C7A(5) in relation to use of system and condition C7B (11) in relation to connections.

3.13. In the context of the development of Ofgem’s proposals for NGC’s SO incentives to apply from April 2003, and in the light of deficiencies perceived by Ofgem in respect of the operation of existing arrangements, NGC has taken forward a charging review.

3.14. On 12 September 2003 NGC put forward for consultation three modification proposals to change its connection and use of system charging methodologies in England and Wales. The first related to the introduction of a shallow connection policy, the “Plugs methodology”, and associated removal of Land Charges, Termination Charges in relation to shared assets and changes to calculation of Site Specific Maintenance charges. The second concerned the introduction of a DC load flow model for estimating locational charges based on the additional costs imposed by additional use at each point in the network. The third was to introduce a non-locational flat year round tariff to recover 10% of the annual Transmission Network Use of System (TNUoS) revenue.
across daytime hours, specifically between 0700hrs and 1900hrs. NGC's consultation closed on 10 October, and all the non-confidential responses have been published on their website\textsuperscript{17}.

3.15. NGC submitted its conclusions reports to Ofgem in respect of modifications to implement a ‘plugs’ connection charging methodology and to adopt a DC load-flow model for the purposes of calculating locational transmission charges on 21 November 2003. NGC decided not to proceed with its proposal for a within-year tariff. Ofgem has until 19 December 2003 in which to decide whether it wishes to veto either of these modifications.

3.16. On 13 October Ofgem issued a consultation on a possible change to NGC's transmission licence to allow NGC to continue to levy charges for post-Vesting connection assets if the Plugs model is implemented. This is available on Ofgem’s website\textsuperscript{18}. Ofgem published its statutory 28-day consultation on licence modifications on 19 November.

**Review of the structure of distribution use of system charges**

3.17. Ofgem and the industry have been working for some time on a project to review the structure of charges levied by electricity distribution companies. One of the key drivers for this work has been the extent to which the existing structure of distribution charges is appropriate given the continuing growth of distribution connected generation.

3.18. The August document noted that this work had progressed through consultation and a series of open workshops. It also noted that Ofgem proposed to establish a steering group, as a forum for

\textsuperscript{17} [www.nationalgrid.com/uk/indinfo/charging/mn_modifications.html](http://www.nationalgrid.com/uk/indinfo/charging/mn_modifications.html)

\textsuperscript{18} [www.ofgem.gov.uk](http://www.ofgem.gov.uk)
discussion rather than a decision making body, to further progress this work. The Implementation Steering Group (ISG) initially met on 25 September 2003. Proposed terms of reference for the group were subsequently published on 10 October 2003. These set out the key objective of the group as being to consider the issues associated with adopting a common set of distribution charging objectives, the boundary between connection and use of system charges and the introduction of generator distribution use of system charges. The terms of reference also confirmed that the Group would meet bi-monthly, it would comprise a small cross section of the industry chaired by Ofgem and would run at least initially until the end of 2004.

3.19. This work is being taken forward with the intention that changes to the present charging regime should be timed to come into effect no earlier than the start of the next distribution price control period in April 2005. However, it is also recognised that some changes may take longer than this and may potentially not come into effect until 2010.
4. Charging framework to support a competitive GB wholesale market

Introduction

4.1. This chapter sets out respondents’ views on and Ofgem/DTI conclusions in respect of the proposed framework for setting transmission charges in a GB wholesale market.

4.2. In the August document Ofgem/DTI noted that a common approach is used currently for the regulation of charges levied by network monopolies in the energy sector in GB. This approach is based on revenue restrictions set out in licence conditions, and the basis on which charges are set in order to recover allowed revenue being subject to regulatory oversight via the requirement for charging statements and methodologies to be approved by the Authority.

4.3. All parties who commented on Part 1 of the August document supported the current licence driven approach as a basis for developing GB transmission charging arrangements. Ofgem/DTI note that in response to the June consultation on Transmission licences under BETTA, one respondent argued for more of the substance of the charging conditions to be moved out of the licence and into the CUSC such that parties other than the Authority could propose changes to these. This issue was also raised by respondents to the August document in context of existing governance arrangements in England and Wales and are outlined below in relation to the basis of licence conditions.

19 Regulatory framework for transmission licensees under BETTA - Second consultation on electricity transmission licences under BETTA: An Ofgem/DTI consultation – June 2003 #59/03
4.4. This chapter sets out a summary of Ofgem/DTI proposals, respondents’ views and Ofgem/DTI’s subsequent conclusions in relation to the individual aspects of this framework consulted on in the August document. These are:

♦ the contractual interface between users and the transmission sector

♦ responsibility for developing charging methodologies and statements

♦ the basis of GB charging licence conditions including governance issues, and

♦ the requirement for non-discrimination provisions in relation to both the treatment of internal and external costs TO costs and the treatment of non-affiliated TOs.

4.5. The remainder of this chapter considers in turn each of the matters identified in the above list.

**Contractual interface arrangements**

**Ofgem/DTI proposals**

4.6. In the August document Ofgem/DTI set out the view that the GB system operator should be the contractual interface between users and the transmission sector in respect of all use of system and non-contestable connection activities. As a result it was proposed that the GB system operator should be the only party who recovers costs in respect of transmission services provided to users across GB.

**Respondents’ views**

4.7. Nine respondents commented specifically on the proposal that the GB system operator should recover costs in respect of transmission
services. Of those, eight supported this proposal. Two of those respondents noted that only by doing so could charging arrangements be developed objectively and consistently across the transmission system.

4.8. One party expressed concern regarding the interface arrangements by which the GB system operator would be the single point for collecting revenue in respect of services provided by TOs. Specifically, the respondent sought detailed proposals on cash-flow management and the management of associated risks such as counterparty risk.

**Ofgem/DTI conclusions**

4.9. Respondents’ views reinforce Ofgem/DTI’s view that under a GB charging regime sole responsibility for contracting with users in respect of transmission services should rest solely with a GB system operator. To create the basis for open and non-discriminatory access arrangements it is imperative that the party devising the charging methodologies and providing the contractual interface with users is demonstrably independent of all generation and supply interests. Under GB arrangements the GB system operator in light of its licence obligations and subject to regulatory oversight is the most appropriate party to meet these criteria.

4.10. In relation to cash flow issues associated with the GB system operator recovering revenue, the August document recognised the requirement for the interface between the GB system operator and transmission owners in respect of procuring services to be separately regulated. These issues were discussed in Ofgem/DTI’s December 2002 paper on the STC and the contractual interfaces
between transmission licensees\textsuperscript{20}. This set out that specific sections of the STC would address among other things any arrangements for security cover between the GB system operator and transmission owners, the treatment of bad debt and interest on over and under payment, and will further addressed in forthcoming STC consultations.

**Charging methodologies and statements**

**Ofgem/DTI proposals**

4.11. Ofgem/DTI regard it necessary that the GB system operator produces the charging methodologies and statements to apply across GB. This is essentially a corollary to the view that that the GB system operator should provide the contractual interface with, and therefore recover all revenue from users. There are two principal reasons for this. First, the charging arrangements should be developed by a party independent of generation and supply interests. Second, transmission charges should be set on a consistent basis across GB. Therefore, given the relationship that a GB system operator will have with users across GB and given that the GB system operator will be independent of generation and supply affiliations, it is best placed to deliver the requisite independence and consistency.

**Respondents’ views**

4.12. Eleven of the twelve respondents who commented specifically on the proposition that the GB system operator should produce the charging methodologies and statements to apply across GB supported that proposal. Three respondents who supported the

\textsuperscript{20} Regulatory framework for transmission licensees under BETTA Volume 3: The SO – TO Code and other contractual interfaces between transmission licensees – Ofgem/DTI, December 2002 #88/02
proposal noted that the continuation of different charging arrangements across GB create would create distortions which frustrate competition and lead to inefficiency. One of those respondents went further highlighting that if the TOs were to create their own methodologies and statements it would compromise the objectives of the BETTA reforms. One respondent, who supported the proposal, noted that should expedience in developing STC arrangements favour a structure whereby the TOs created their own methodologies and statements subject to requirements for consistency, this would not significantly compromise BETTA’s objectives.

4.13. A number of respondents while supporting the general principle that the GB system operator should produce charging methodologies suggested a number of areas where changes would be required to facilitate this arrangement.

4.14. One respondent noted that the GB system operator will require information from the non-affiliated TOs in order to put in place, maintain and develop a GB charging methodology. The respondent argued that this should be facilitated by a requirement on the TOs via the STC.

4.15. Another respondent expressed concern about the role of the GB system operator in charging for connections from the perspective of competition. The respondent noted that, insofar as the connection charging arrangements were concerned, the GB system operator could disclose the price of Scottish transmission business offers to its affiliate transmission business in order to provide a competitive advantage and that scope was needed for an independent audit. The same respondent sought clarification on the position in paragraph 5.5 of the August document that the GB system operator would be connection service provider of last resort. The respondent questioned how this would work as only the TOs could provide a connection to the transmission networks
4.16. A third party noted that as the TOs will have the responsibility for constructing transmission assets, a range of payment options can only continue to be available if the transmission business is the party to the construction agreement and the GB system operator is simply the agent for recovering the TOs’ costs under the terms of the bilateral connection agreement.

Ofgem DTI conclusions

4.17. Ofgem/DTI regard the proposal that the GB system operator produces the charging methodologies and statements to apply across GB as the only approach consistent with the objective of creating a competitive GB market, and welcome respondents’ support for this approach.

4.18. In respect of the GB system operator’s requirement for information from the TOs in order to produce charging methodologies and statements, Ofgem/DTI recognise that there will be ongoing information requirements. Indeed, data exchange is one of the key functions of the STC. Consequently, Ofgem/DTI agree that provision for the sharing of information should be addressed through the STC. Ofgem/DTI intend to consult in due course on the issues of information provision in general under the STC.

4.19. On the issue of charging for connections, Ofgem/DTI continue to believe that all users of the transmission system should, with the exception of users who exercise choice over their service provider for contestable connection services, contract with the GB system operator for connection to and use of the transmission system. In Ofgem/DTI’s view this is the most effective way of ensuring non-discriminatory access to the transmission system, thereby promoting effective competition. Ofgem/DTI recognise parties concerns regarding the scope for the GB system operator to favour its affiliate in charging for connection but believe that these concerns can be addressed through appropriate non-discrimination
provisions within the GB system operator’s licence. These issues will be addressed in Ofgem/DTI’s forthcoming paper on Transmission Licence Conditions under BETTA due to be published in December and are further discussed in the context of wider non-discrimination provision later in this chapter.

4.20. One party requested that Ofgem/DTI clarify what it means by the GB system operation being ‘connection provider of last resort’. This refers to the proposal for the GB system operator to be obliged under its licence to offer terms for connection to the transmission system in respect of contestable areas where the user can choose from competing service providers. It does not refer to the construction and ownership of the requisite transmission assets, responsibilities for which will be determined under the STC.

Basis of GB charging licence conditions

Ofgem/DTI proposals

4.21. Ofgem/DTI proposed that regulation of the GB system operator’s transmission charges should be based on the obligations currently in force for NGC. These are set out in supplementary Standard Conditions C7 to C7E of the company’s electricity transmission licence and relate to:

♦ C7 – setting charges for use of system
♦ C7A – preparing a use of system charging methodology
♦ C7B – preparing a connection charging methodology
♦ C7C – non-discrimination in relation to providing and charging for use of system and connection
♦ C7D – requirement to offer terms for connection to and/or use of its transmission system, and
C7E - the functions of the Authority in resolving disputes in relation to connection and/or use of system.

4.22. The full text of these conditions was set out in an appendix to Part 1 of the August document.

4.23. Separately, in Part 2 of the August document, DTI sought views on whether this set of obligations needed to be augmented to provide for lower charges for renewables in the light of Government targets for growth in renewables and the prevailing package of support for such generators.

**Respondents’ views**

4.24. Twelve respondents commented on the proposal to use NGC’s existing transmission charging licence conditions as a basis for setting GB transmission charging obligations.

4.25. Nine supported the proposal as appropriate for regulating the GB system operator. Another respondent while supporting the proposal noted that conditions require to be more widely reviewed to establish whether they require revision for BETTA.

4.26. One respondent expressed the view that NGC’s current licence conditions provide an inappropriate framework for developing GB transmission charging methodologies. The respondent argued that BETTA requires these to be fundamentally reviewed in order to take into consideration the issues associated with arrangements that apply across three transmission areas including addressing different security standards and the differential treatment of 132kV circuits. The same respondent also noted that the GB system operator’s licence conditions will have to reflect imminent changes to European legislation and the development of UK energy policy in particular in relation to new draft social and environmental guidance on security of supply and the promotion of renewables.
4.27. A number of respondents, irrespective of whether or not they supported using NGC’s existing transmission licence conditions, highlighted some changes that should be made to specific licence conditions when applying these in a GB context.

4.28. One respondent highlighted three areas where changes would be needed to the existing licence obligations to reflect different interactions between the GB system operator and TOs. First to account for the fact that different connection/infrastructure boundaries currently exist across the three TOs the respondent proposed that a GB boundary should be established in the licence, rather than being reflected in the charging methodologies and statements as is presently the case. Second the respondent noted that as the relevant objectives require both that transmission charges reflect, as far as reasonably practicable, the costs incurred by the licensee in its transmission business and to take account of developments on the licensee’s transmission business, the conditions would need to be revised to reflect the appropriate costs incurred by each transmission licensee and to capture developments in each of the transmission licensees’ areas. Finally the respondent argued that the objective on the system operator to facilitate competition in connections on the licensee’s transmission system was no longer appropriate under the BETTA framework and should be placed on the individual transmission activities.

4.29. Another respondent argued that there are trade-offs under NGC’s existing licence objective set under C7A (5) and that this condition should be modified such that the facilitation of competition in the generation and supply of electricity is the prime objective and that the objectives relating to cost reflectivity and accounting for developments on the transmission systems should be given a subsidiary role.
4.30. On a similar vein another respondent put forward the view that cost reflectivity is a misplaced objective and that the overarching objective of any charging arrangement should be economic efficiency and stability.

4.31. On the issue of the charging differentials produced by a locational charging methodology such as ICRP, one respondent argued that these differentials should be capped through Standard Condition C7C to ensure that outlying areas are not subject to undue discrimination.

**Governance**

4.32. In addition to responses summarised above, a significant number of respondents commented on governance under the current arrangements in England and Wales. These views are summarised below.

4.33. Nine parties expressed a view that current governance arrangements give an inadequate voice to users of the transmission system in developing transmission charging arrangements. They argue that they lack transparency and flexibility and that further scope should be provided for users to propose changes. Currently, users respond to changes proposed by NGC.

4.34. Three parties argued that in line with the process for modifying the BSC or CUSC any party who is subject to connection or use of system charges should be able to propose modifications.

4.35. A further three parties noted that greater involvement of parties in developing charging arrangements could address discrimination issues as non-affiliated TOs would be more involved in the development and maintenance of the charging methodologies and could raise modifications.

4.36. Another two parties argued that there should be a more rigorous impact assessment, including cost-benefit analysis, of all proposed...
modifications and the consultation report issued for further consultation before being submitted to Ofgem.

4.37. One respondent argued for a process in which changes put forward by other parties should either have to be reviewed by the GB system operator and, if not progressed, justification as to why not should be provided by the GB system operator to the Authority. On a similar vein another respondent argued that at a minimum the GB system operator should be obliged to incorporate all users’ comments in full in the final report to the Authority rather than a summary.

4.38. A number of more detailed solutions were put forward by respondents. Two parties suggested that the CUSC panel should be provided with wider powers to require NGC to take forward modifications widely supported by the industry. Another solution suggested by a respondent would be to place the Transmission Charging Methodology Forum (TCMF), the existing industry forum that allows users to become involved in the development of NGC's charging methodologies, on a formal footing via a licence obligation for the GB system operator and that chairmanship should not rest with the GB system operator. A third respondent noted that users need representation on the governing body of the STC.

**Ofgem/DTI conclusions**

4.39. This section sets out Ofgem/DTI’s conclusions on the proposal that the GB system operator should have licence obligations in respect of charging that are based on NGC’s existing licence conditions. It also sets out Ofgem/DTI’s views in respect of the points raised on governance.

4.40. Ofgem/DTI continues to support the view that the GB system operator should have licence obligations in respect of charging that are based on NGC’s existing licence conditions. Depending on DTI’s conclusions in respect of Part 2 of the August document, it
might be viewed by DTI as appropriate to augment these licence obligations to provide for lower transmission charges for renewable generators (or a subset of renewable generators) as a means of promoting renewable generation. The DTI will conclude on this issue shortly.

4.41. Ofgem/DTI note that a number of respondents’ have questioned the appropriateness of the existing licence conditions given existing differences across the three transmission areas. These are identified in relation to areas such as security standards, the treatment of 132kV circuits and the boundary between connection and infrastructure assets. In Ofgem/DTI’s view none of these issues invalidates the use of NGC’s existing licence conditions as the basis of GB conditions or therefore requires specific amendments to those conditions.

4.42. The principles embodied in the licence conditions are generic in nature. There is no obvious reason why, for example, a transmission network including 132kV circuits in Scotland should not enable cost-reflective charges and promote competition. To the extent that a 132kV network results in different cost drivers for a transmission business, then the requirement to develop charges that reflect the costs of the transmission businesses of the licensees should result in this being factored into the development of the charging methodology. Similarly, the fact that there are differences currently between licensees in how the connection boundary is defined would be reflected in charges and thus would seem to have little relevance to the obligation placed on the GB system operator in respect of charging which will be an overarching principle under BETTA.

4.43. Ofgem/DTI recognise that under BETTA different planning and operating standards may apply to different parts of GB. However, setting aside the issue of the quantity of access rights to afforded to existing users under BETTA and the treatment of localised
operational issues, on an ongoing basis it is anticipated that the contractual terms for connection and use of system will be based upon those in place in the existing England and Wales CUSC. As this is the case, the contractual arrangements for access to the system will, essentially be firm with compensation paid where access is denied. As a consequence, it is envisaged the rights afforded to all GB users are anticipated to be broadly the same under BETTA and should not necessarily be a function of the local planning or operating standard employed. Therefore, despite differences in planning standards there is no requirement for these to be reflected in the charging regime.

4.44. Ofgem/DTI also do not agree that the objective on the system operator to facilitate competition in connections on the licensee’s transmission system is no longer appropriate under the BETTA framework. Under its licence the GB system operator will be the party responsible for developing and implementing the GB charging regime. That charging regime will include provisions for contestable aspects of connection. Consequently, in undertaking its responsibilities in terms of the charging regime the GB system operator should require to take into consideration the impact of competition in carrying out works for connection. As discussed previously, any concerns regarding the scope to manipulate where competition in connections develops thereby favouring one TO or disadvantaging another should be addressed through non-discrimination provisions. However, in any event Ofgem/DTI considers that a positive obligation to facilitate competition in connections should mitigate against discriminatory practices occurring.

4.45. At the same time Ofgem/DTI agrees with one respondent that changes would be required to the relevant objectives to take account of a number of areas where the GB system operator will have to consider the impact of changes across three transmission areas rather than one. These include objectives 5(b) and 5(c)
relating to reflecting the appropriate costs incurred by each transmission licensee and taking account of wider developments on the different transmission systems. It is intended that these provisions will be set out in Ofgem/DTI's forthcoming paper on Transmission Licence Conditions under BETTA due to be published in December.

4.46. Ofgem/DTI also note that a number of the responses in relation to the GB licence conditions concerned making more fundamental changes to existing objectives or adding new objectives to reflect wider policy areas. Similarly a significant number of responses have been received in relation to the scope for users to bring forward modifications to alter the governance arrangements of the charging conditions and industry codes. In seeking to implement BETTA, Ofgem/DTI has adopted an approach whereby only changes that are necessary or expedient for the creation of a competitive GB market are proposed. The scope of legislation being sought to facilitate the implementation of BETTA has been explicitly limited on that basis. On the basis that existing arrangements in England and Wales support a competitive market, wider policy questions (other than the specific issue of support for renewables upon which the DTI explicitly extended the scope of consultation through Part 2 of the August document), such as the appropriateness of existing governance arrangements or the need for changes to relevant objectives, are therefore outside the scope of BETTA.

4.47. In response to the specific comment by a number of respondents regarding the scope for greater involvement of the TOs in the charge setting process it is Ofgem/DTI view that it would be inappropriate, and indeed inconsistent with the justification for developing a GB system operator to be the independent contractual interface with users, if TOs were able to influence the user charging process. However, it is recognised that NGC, in applying the charging methodologies under BETTA and developing these methodologies over time, will require information from
transmission owners. It is intended that the STC will provide for the exchange of this information.

Equivalent cost treatment and non-discrimination between TOs

Ofgem/DTI proposals

4.48. In proposing that NGC’s existing transmission charging licence conditions could be used as a basis for regulating GB transmission charges Ofgem/DTI recognised that it was possible that refinements might be required to specific aspects of the existing conditions. One area in particular where it was recognised that changes may be required was to reflect the interactions between the GB system operator and non-affiliated TOs, pursuant to the new structure of transmission under BETTA, in order to ensure that the charging regime is non-discriminatory.

4.49. In the August document Ofgem/DTI identified and sought respondents’ views on two specific areas where potentially refinements would be needed to the licence conditions. The first was to ensure that internal and external costs are charged out to transmission users on a consistent basis by the GB system operator such that activities carried out by the GB system operator by means of services provided by non-affiliated TOs are treated on the same basis as costs associated with comparable internal activities. The second was to ensure that the GB system operator does not set its charges in a manner that favours itself over non-affiliated TOs e.g. by attempting to set charges that encouraged new users to connect at points in the network that stimulated the need for investment in its own network assets or vice versa.
Respondents’ views

Consistent treatment of internal and external TO-related costs

4.50. Five respondents commented specifically on the scope for inconsistency in the treatment of internal and external transmission business related costs.

4.51. One respondent highlighted that since any potential changes to the methodology or structure are subjected to industry wide consultation, any potential abuse should be highlighted enabling Ofgem to reject any changes it would consider discriminatory. Consequently the respondent argued that it would not be in the best interests of the GB system operator to undertake such manipulation.

4.52. The other four respondents expressed concerns that the division of system operator/TO revenue could create perverse incentives. One respondent suggested that those incentives could result in the GB system operator acting in a manner that would be to the detriment of customers and the system as a whole. Another respondent argued that Ofgem/DTI should consider whether any costs incurred by the GB system operator in collecting revenue and making payments to the TOs should be controlled and/or incentivised as ultimately these will be passed through to users.

Non-discrimination of non-affiliated TOs

4.53. The majority of comments on changes to licences were in relation to the scope of the GB system operator to discriminate in favour of its affiliate TO and against a non-affiliate TO. Eight respondents commented specifically on this subject. Of those, six respondents argued that existing licence conditions will need to be revised to allow conditions to operate effectively given the structural changes
to the transmission sector under BETTA, and the consequent scope for a GB system operator to discriminate against non-affiliated transmission owners through its transmission charging methodologies.

4.54. One respondent argued that it was not necessary to create additional licence conditions as the existing Standard Condition C7C prevents discrimination in the provision of use of system and the carrying out of works for the purpose of connection between “any persons or class or classes or persons”

4.55. Another respondent highlighted that there was scope for discrimination by the GB system operator giving insufficient weight to a non-affiliated TO’s legitimate interests for example in system security and promoting network investment. That respondent argued that as a minimum, there must be an amendment to NGC’s relevant objectives to ensure the GB system operator must have regard to the interests of each TO, including its regulatory duties and ability to discharge its obligations, and separately to treat its affiliated TO in exactly the same way as it treats any other TO.

4.56. A number of respondents expressed a view that additional licence obligations would be sensible to provide non-affiliated TOs with additional comfort to ensure the services they provide are charged out on the same basis as activities undertaken by the GB system operator itself. One respondent noted that while Standard Condition C7C(1) of NGC’s electricity licence already has a general non-discrimination provision this may need to be expanded to ensure that all TOs were subject to the same conditions in providing services. Three other respondents noted that the appropriate place in NGC’s electricity licence to address non-discrimination was thorough the relevant objectives of the use of system charging methodology.
4.57. Four respondents went further arguing that the only way to ensure there was no discrimination was if the functions of the TOs and the GB system operator were separately licensed.

**Ofgem/DTI conclusions**

4.58. Ofgem/DTI recognise that the restructuring of the transmission sector pursuant to BETTA will create the opportunity for new forms of discrimination potentially to be exercised in terms of the interaction between the GB system operator and non-affiliated TOs. The charging methodologies are one possible vehicle for discrimination to be exercised by the GB system operator against non-affiliated transmission owners. Such behaviour by the GB system operator should be prohibited.

4.59. One respondent suggested that existing licence condition C7C (‘Non discrimination’) are sufficiently wide in scope to address this issue. While Ofgem/DTI recognise that discrimination in favour of an affiliated transmission owner business might also result in discrimination against certain classes of users, it is Ofgem/DTI’s view that a more direct prohibition is appropriate.

4.60. In the June paper on the transmission licence conditions to apply under BETTA, Ofgem/DTI proposed the introduction of an additional non-discrimination provision to address possible discrimination by the GB system operator against non-affiliated transmission owners, and identified additional specific steps that could be taken to help prevent such discrimination. In relation to possible concerns regarding discrimination by the GB system operator, the August document sought views on whether it would appropriate to extend the relevant objectives set out in supplementary standard condition C7A (‘Use of System Charging Methodology’) or its equivalent under BETTA to ensure that charging methodologies did not in object or effect discriminate against other transmission licensees.
4.61. In the light of consultation responses, Ofgem/DTI do not consider that such action is required. Ofgem/DTI consider that the introduction of a general prohibition for the GB system operator not to discriminate in favour of its own transmission owner activities, combined with Ofgem’s approval of the charging methodologies and the public consultation exercises that would precede such regulatory scrutiny by Ofgem, will provide sufficient protection for transmission owners under BETTA.

4.62. Furthermore, Ofgem/DTI do not believe that further provisions are required to address the charging out of internal and external costs. The scope for discrimination against those paying transmission charges will be the same under BETTA as under the existing charging arrangements in England and Wales. On this basis the provisions of Standard Condition C7C should address any form of potential discrimination.

4.63. The issue raised by four respondents on the need to separately licence system operation and TO functions in order to ensure non-discrimination was consulted on the June paper on transmission licences under BETTA. Consequently, this issue will be addressed in the forthcoming paper on transmission licences due to be published later this month.
5. Implementing a GB charging regime

Introduction

5.1. This chapter summarises Ofgem/DTI proposals from the August document, summarises respondent view of these proposals and in light of these sets out conclusions on the following areas:

♦ the basis of the initial GB charging consultation

♦ the process and timetable for developing GB charging arrangements including the implications stemming from the NGC’s current review of charging arrangements in England and Wales

♦ issues associated with the geographic recovery of costs, and

♦ issues associated with who pays use of system charges.

Basis of consultation

Ofgem/DTI proposals

5.2. In the August document Ofgem/DTI set out the view that the starting point for consultation on GB charging methodologies should be the charging arrangements that are in place in England and Wales. Two principal reasons were identified why this is appropriate. These were:

♦ the majority of the GB transmission system will comprise the assets that presently form the transmission system in England and Wales, and

♦ the England and Wales charging framework represents a well documented and well understood baseline for consultation.
5.3. However the DTI consulted on separate proposals to assess whether the obligations on which the charging methodology were based for renewables or for a particular class of renewables was appropriate. The responses to this part of the consultation will be analysed in the DTI’s conclusions to Part 2.

**Respondents’ views**

5.4. Eleven respondents commented on the methodology that should form the basis of the initial GB charging consultation. Of those, eight respondents expressed support for using England and Wales charging arrangements as the basis for consultation. A number of those who commented noted that this would be the simplest, least disruptive approach, and would provide a solid basis with which the market is familiar.

5.5. One respondent did not believe the GB transmission charging methodologies should be based on prevailing methodologies in England and Wales. That respondent argued that to do so would be inconsistent with European regulations including Article 7(6) of the renewables directive, which requires that charging of network charges does not discriminate against electricity from renewable sources. The respondent argued that the extension of the existing Incremental Cost Related Pricing (ICRP) methodology by increasing transmission charges for generators in Scotland would result on average in renewable generators facing higher charges than non-renewable generators.

5.6. The respondent also argued that there is no requirement for locational signals and that a postage stamp methodology or compromise approach such as the network tracing\(^{21}\) methodology used on the European continent could be regarded as both cost

\(^{21}\) An approach used for determining how much each of a number of trades uses different parts of the electricity network. The scheme is based on the assumption that at any network node, inflows are shared proportionally between outflows and vice versa.
reflective and non-discriminatory. It argued that the existing NGC model of locational charging was designed for a network almost entirely supplied by conventional generation and that intermittent generation such as renewables generation would incur excessive costs.

5.7. The same respondent put forward instead a number of principles to which a future GB charging regime should adhere. Those principles included that charges reflect actual costs and should not be distance related. It argues that the principles of notional cost and distance related charging are inconsistent with Article 4.1 of the European Regulation on cross-border exchanges (1228/2003).

5.8. It also argued that any charging regime should be truly cost reflective unlike a regime based on notional future incremental investment costs. It should also not be based on marginal costs as under such a regime incremental costs at their periphery of the network are sensitive to the dispositions of generation and demand. Finally, it should result in predictable stable charges over a number of years through multi-year contracting.

5.9. A number of other respondents also put forward comments on the appropriateness of a location based charging regime such as the ICRP arrangements which currently applies in England and Wales. One respondent argued that appropriate and consistent locational charging is fundamental to the efficient, economic and competitive operation of the transmission network by incentivising the efficient siting of generation and demand. However, the respondent qualified that position by noting that it is important that the overall level of locational signals is appropriate and locational charges are applied consistently to all transmission users across GB.

5.10. Two other respondents expressed concern that the extension of the existing ICRP arrangements would significantly increase generation charges in Scotland. Both suggested that in order to protect generation, transitional arrangements were needed in order
to shield peripheral generation and demand from step changes in charges that their financing could not support. One respondent suggested that changes to the charging framework should be phased in to create some stability and prevent a significant material impact on some companies.

5.11. Another respondent suggested that the principle of cost-reflectivity might be compromised by the introduction of GB charging, as Scotland accounts for 10% of GB demand but a higher proportion (30-40%) of transmission assets. The respondent argued that if these costs were not addressed in locational charges, a cross-subsidy would be created resulting in economic inefficiency.

5.12. One respondent noted that the development of a GB charging arrangement had presented the opportunity for a full review of charging methodologies including issues in England and Wales, such as the continuation of triad and negative charging zones and the effect of licence exempt generators on charges.

**Ofgem/DTI conclusions**

5.13. Given the significant support received for the principles set out in the August document, Ofgem/DTI continue to support the proposal that the initial GB system operator should use prevailing arrangements in England and Wales as the basis for consulting on the development of GB transmission charging arrangements. However, the DTI notes the concerns raised by respondents about the impact of ICRP on renewables, particularly in Scotland, and will be concluding on Part 2 of the consultation shortly. For the avoidance of doubt, in the present circumstances where NGC has brought forward change proposals but the time period within which Ofgem can veto either or both of the proposals has not yet expired, it is Ofgem/DTI’s view that the initial GB consultation should be based on the methodology incorporating the proposed
changes. While this could result in nugatory work if any of the change proposals are subsequently rejected by Ofgem, it does enable the consultation process to start. The use of this working assumption will not in any way influence the consideration by Ofgem of the proposed changes in England and Wales.

5.14. Ofgem/DTI recognise that there were however a number of comments on the specific detail of future charging arrangement. The purpose of the August document was to consult on the appropriate principles of GB charging. In relation to the basis of the charging arrangements Ofgem/DTI proposed that the existing arrangements in England and Wales should represent a starting point for the purposes of consultation. The detail of the arrangements should be addressed through the initial GB system operator’s consultation, which should be initiated shortly. Ofgem will have regard to the issues raised and views provided during that consultation process when the GB system operator proposes a GB charging methodology for Ofgem’s approval.

5.15. At the same time Ofgem/DTI do not agree that the introduction of BETTA is an opportunity for fundamental review of existing charging arrangements including the concept of cost reflectivity. The key justification for using the existing charging framework in England and Wales is that the issues presented in developing a charging regime for GB are similar to those presented when developing a charging regime for England and Wales. On the basis that the existing licence objectives for the regulation of charges in GB is the appropriate one, the existing arrangements in England and Wales represent a well documented and well understood baseline for consultation. If the existing arrangements were fundamentally reviewed it would only serve to undermine the stability and certainty that this approach affords and further complicate the process for developing GB charging arrangements.
5.16. In relation to one respondent’s comments on the impact on renewables of extending the England and Wales charging arrangements to Scotland, it should be noted that it was with consideration of the specific impact of those proposals on renewables that the DTI consulted on transmission charging options, in the light of the existing package of support for renewables, in Part 2 of the August document. DTI’s conclusions on this issue will be issued shortly.

5.17. [On the issue of consistency with current European legislation, given that existing arrangements in England and Wales are consistent with EU law, Ofgem/DTI are of the view that GB transmission arrangements based on extending these arrangements to Scotland will also be consistent on a legal basis.]

**Process and Timetable**

**Ofgem/DTI proposals**

5.18. In the August paper, Ofgem/DTI proposed that the consultation on the charging methodologies should be led by the initial GB system operator. Ofgem proposed that the initial GB system operator publish its initial thoughts in November/December 2003, initial proposals in March 2004 and a consultation on its final proposals by October 2004. Thereafter the proposals should be submitted to the Authority for a decision consistent with what is envisaged to be the process that would apply under the GB system operator’s licence condition.

**Respondents’ views**

5.19. Of the thirteen respondents who commented on process and timetable issues the majority supported the basis set out in the August document for the initial GB system operator to develop and consult on its proposed charging methodologies. Five respondents supported the process as an appropriate framework for setting the
initial BETTA methodologies. Two further respondents agreed with the proposal that NGC should make extensive use of workshops and seminars within this process to allow users input at an early stage. One respondent questioned how, as the GB system operator was not subject to any regulation in relation to developing GB transmission charging arrangements, its activities would be governed in this area.

5.20. Three respondents explicitly criticised the basis of the process. Two of those respondents argued that the process of replicating the existing arrangements is inadequate. The third respondent argued that the direct effect on participants and their consequences should be clearly identified and decisions taken on how to handle them at a policy level before responsibility for developing charging arrangements is passed to the initial GB system operator.

5.21. Three respondents argued that further details on the nature of GB charging arrangements rather than just high level principles should have been consulted upon at an earlier stage. One respondent expressed disappointment that indicative transmission charges under a GB charging arrangement had not yet been provided. They argued that this was having an adverse affect on the investment decisions of small generators.

5.22. There were five responses on the timetable set out in the August document. Two respondents suggested that there should be a longer time period for the initial GB system operator to develop and consult on a new transmission charging methodology. Another two respondents argued that there are additional project risks associated with undertaking a third consultation following Royal Assent to the Energy Bill. The respondents argued that it would be necessary to progress the GB charging methodologies as far as possible before Royal Assent to allow for the development of processes and systems and thus that should the third consultation
result in significant change to the charging rules then it may not be possible to calculate GB transmission charges for April 2005.

5.23. Five respondents argued that the process had been hampered by the fact that the small generators paper had not been published at the same time as the August document. They noted that as a result comments on the August paper were hamstrung by the absence of a key piece of the overall picture. Three parties expressed regret that as a result the treatment of small generators would not be taken into consideration by the initial GB system operator in providing indicative charges. One respondent argued that as a result it may now be necessary for a further round of analysis and consultation in March 2004 to take into account the conclusions on the treatment of small generators and 132kV circuits. In order to complete the consultation process by October 2004 the respondent argued that the document after March 2004 should set out conclusions.

5.24. Three respondents argued that an important part of the process was the interaction between DTI and Ofgem. Two respondents put forward the view that to provide for regulatory certainty there would have to be joined up thinking between Ofgem and the Government. The respondents suggested that if this was absent this could affect the approval of the initial charging methodologies. Another respondent argued that as BETTA was a joint development programme between Ofgem and DTI, the initial charging methodologies should be approved by both parties.

**England and Wales charging review**

5.25. A number of comments were received in relation to NGC’s current review of its charging methodologies in England and Wales. Five respondents noted that a full consultation would be required to consider the suitability of these arrangements for GB. Of those, one respondent noted that the initial GB system operator’s consultation would be more meaningful if the outcome of revisions
to charging methodologies in England and Wales were known before consulting on a GB basis. Two respondents expressed the view that the reforms proposed in England and Wales from 1 April 2004 are appropriate on a GB basis and expressed their hope that any changes would be included as part of the basis for GB charging arrangements.

5.26. Two other respondents questioned the timing of the England and Wales charging review. One respondent noted that the fundamental nature of the review had increased uncertainty and regulatory risk for market participants. The other respondent argued that the content of the review should be irrelevant to the future GB arrangements and that the diversion of industry resources it represented had put additional pressures on the BETTA timetable. The respondent argued that the review should be suspended to allow for concentration on GB issues.

**Ofgem/DTI conclusions**

5.27. Ofgem/DTI welcome respondents’ support for the broad process outlined in the August paper. Ofgem/DTI continue to believe that process is appropriate for developing GB charging arrangements. To ensure users are fully involved in the process Ofgem/DTI continue to advocate that the initial GB system operator should make full use of workshops and other industry forums.

5.28. The question of how the GB system operator’s actions will be governed in relation to the process was outlined in the Ofgem/DTI August 2002 conclusions paper on the process for identifying the GB system operator\(^\text{22}\). This set out that the GB system

\(^{22}\) The process for identifying the GB system operator: Key conclusions and invitation for applications Conclusions document – Ofgem/DTI, August 2002
operator would commence preparatory work on the production of a number of documents having regard to licence obligations which will come into effect after Royal Assent.

5.29. In relation to the comments received regarding whether the process should have provided more details, Ofgem/DTI reiterate the point that the purpose of the consultation was only to establish the high level principles. It is appropriate that the detail, as is intended will be the case under the enduring arrangements, is addressed through the initial GB system operator consultation. Having said that Ofgem/DTI recognise that it would have been preferable if additional information on the treatment of small generators and 132kV circuits had been available at an earlier stage.

5.30. However, Ofgem/DTI note that the initial GB system operator’s consultation timetable will provide opportunity for respondents to both consider and comment on these issues in full on a GB basis. On the same basis, Ofgem/DTI agree that it would have been beneficial if it had been possible to provide indicative GB charges earlier but believe that given the potential impact of NGC’s review of charging arrangements in England and Wales on locational charges, the decision to publish indicative charges at an earlier stage could have resulted in tariff information that was misleading. It would also have been inappropriate to publish indicative charges before the high level principles for the charging methodologies had been concluded upon.

5.31. It is noted that there are a range of views on aspects of the timetable. Ofgem/DTI consider that the amount of time allocated to the consultation process by the GB system operator should be sufficient to enable a comprehensive and inclusive process to be undertaken. On the issue of the initial GB system operator undertaking a third consultation, Ofgem/DTI continue to be of the view that to fully address the treatment of small generators and
132kV circuits this consultation is required, given the timetable for conclusions by Ofgem/DTI on small generator issues.

5.32. On the issue of whether both Ofgem and DTI should approve the first set of charging methodologies under BETTA it is noted that this responsibility lies specifically with Ofgem under the regulatory framework. DTI has not had a role to date in the approval of charging methodologies, including as part of implementation of the New Electricity Trading Arrangements (NETA).

5.33. Ofgem/DTI recognise respondents’ concerns regarding the interaction of the GB charging review with NGC’s review of the existing arrangements in England and Wales. It is however important to recognise that the market in England and Wales is a live market, and as such it is important that BETTA does not unnecessarily constrain the development of that market. Given that the review does not conflict with the principles or the timescale for developing GB charging arrangements, it would be inappropriate for Ofgem to seek to curtail the review process in any way.

Cost recovery

Ofgem/DTI proposals

5.34. Under the current regulatory framework charges are set independently in the three transmission areas and for the Scotland-England interconnector to recover the total costs of those particular network assets. In the August document Ofgem/DTI proposed that this sub-regional demarcation of costs for the purpose of setting charges would be removed and that the GB system operator would recover the total costs of the GB transmission system from GB users.

Respondents’ views
5.35. Nine respondents commented on the geographical recovery of costs. Of those eight respondents supported the removal of sub-regional demarcation of costs as consistent with developing GB charging arrangements so long as the result was cost reflective.

5.36. One respondent went further arguing that any type of cost incurred by a licensee should be charged out on a consistent basis. In other words they proposed that Scottish system operator costs currently recovered through TNUoS charges should be recovered through GB Balancing Services Use of System (BSUoS) charges rather than GB TNUoS.

5.37. A number of respondents expressed support for GB cost recovery but made additional suggestions. One respondent argued that the different levels of service implicit in the different planning and operational standards should be reflected in the final charges to system users. Another respondent argued that provision should be made for transitional relief arrangements if there are significant changes to costs to be recovered over the three transmission areas to avoid the creation of windfall winners and losers. The material impact was also commented upon by a third respondent who argued that the cost recovery arrangements should be subject to the setting of a maximum differential otherwise the situation could occur where one area pays for another geographical area’s charges. Finally, one respondent argued that BETTA provided an opportunity to introduce consistency in respect of cost recovery with EU transmission charging policy.

Conclusions

5.38. Having considered respondents’ views Ofgem/DTI remain of the view that recovering total costs from all GB users is consistent with introducing GB transmission charging arrangements.

5.39. Ofgem/DTI believe that the different levels of service as a result of different planning and operational standards will be reflected by
recovering costs on a cost-reflective and non-discriminatory basis. As noted in the August document the nature of GB cost recovery arrangements is that recovery may not map exactly on to boundaries but the advantages of this approach are significant in terms of encouraging the efficient development of the GB transmission system, and, given the proposals to charge on a cost-reflective basis, it would be coincidence if the price boundaries matched ownership boundaries. Indeed to explicitly link these matters would be discriminatory.

5.40. Ofgem/DTI do not accept as appropriate the idea of artificially constraining cost recovery differentially. Such an approach would appear to discriminate against those parties who consequently pay high transmission charges than would otherwise be the case. In addition, it is Ofgem/DTI’s initial view that transitional arrangements whereby cost reflective GB charges are phased in over a period of time might not be appropriate, in particular as it is not proposed that that the associated rights and market arrangements be phased. However, it is recognised that there is some precedent for phasing, including the implementation of ICRP in the mid-1990s. This issue would need to be considered further in the light of the detailed proposals brought forward by the GB system operator.

Transmission charge liability

Ofgem/DTI proposals

5.41. Despite differences in their detail, the arrangements currently in place across the three transmission areas embody two broad principles in respect of the liability for charges. Firstly, that all transmission connected generators pay TNUoS. Secondly, that some classes of distribution-connected generation will pay TNUoS charges while some will be exempt from these charges.
5.42. On the basis that the charge liability principles in the Scottish transmission areas are comparable to those in England and Wales and that the latter arrangements have been developed pursuant to licence obligations which will not materially change in the transition to a GB transmission charging regime, Ofgem/DTI proposed in the August document that the existing England and Wales principles should continue to apply in the post-BETTA charging world.

**Respondents’ views**

5.43. Twelve respondents commented in some respect on the liability for transmission charges. Of those the eight who commented on the principles broadly supported those set out by Ofgem/DTI in the August paper.

5.44. Three parties noted that there should be no exceptions for the liability to pay TNUoS charges on the GB transmission system. One of those respondents argued that generation that imposes a cost on the transmission system should contribute to the reimbursement of those costs that it imposes. Another respondent argued that all users should be subject to cost reflective GB charges. The third respondent argued that the case that all generators should pay use of system charges is based on the fact that 1MW of distributed connected generation has the same impact as generation directly connected to the transmission system. The respondent further argued that as the level of distribution connected generation is increasing, consideration is required as to whether the existing arrangements in England and Wales will be appropriate on a GB basis.

5.45. Six respondents commented on the impact of the charging liability on renewables and other small generators. Two respondents argued that the charging arrangements should not disadvantage small generators. One respondent welcomed changes that would support distributed generation and argued that such generators
should continue not to pay transmission charges if licence exempt and that this principle should be extended on a GB basis. Another respondent noted that there may, in future, be a requirement to change arrangements for paying embedded benefits, as existing arrangements in England and Wales are not sufficiently robust to cope with significant embedded generation such as the north of Scotland. One respondent fundamentally opposed changes to charging principles in respect of renewable generators.

5.46. Three parties noted that the question of liability could not be sensibly answered in the absence of a position on the treatment of 132kV generation and small generators. Those parties welcomed Ofgem/DTI’s consultations on this area. Two parties argued that there must be equal treatment for all generators connected at 132kV. One of those respondents argued that liability for TNUoS charges should be based on existing connection agreements and that NGC’s current liability rules for embedded generators should continue to apply.

5.47. Two respondents identified errors in statements made in the August paper with regard to charging liability. The first noted that liability for generator transmission charges was not determined per se on the basis of generator size but rather on the requirement to be subject to central despatch. The second respondent questioned the statement in paragraph 6.9 of the August paper that the exemption from TNUoS for generators who sell under the Scottish Renewables Order (SRO) would have no effect in practice. The respondent noted that under SHETL’s existing arrangements more than half the SRO generators would be liable for TNUoS whereas under NGC’s charging methodology none would be liable for TNUoS charges.

**Ofgem/DTI conclusions**
5.48. In light of respondents’ views Ofgem/DTI reinforce the view set out in the August document that the existing underlying principles underpinning those who pay TNUoS charges under the England and Wales should be used as the basis for the development of charges under BETTA.

5.49. Ofgem/DTI recognise that respondents’ views were decidedly mixed on this subject and tended to fall into two broad subject areas – applicability of the current principles and the treatment of small generators.

5.50. On the first issue the August paper noted that in respect of payment for TNUoS charges there is at present a broad consistency of treatment across GB. These principles have been developed over time to reflect criteria set out in licence obligations. Respondents have not provided any justification why the development of GB charging arrangements requires changing the existing liability for transmission charging to better meet the existing licence requirements. Therefore, while it is recognised that the potential for increasing levels of distribution connected generation may prompt a consideration of future liability arrangements, the move to GB charging arrangements does not necessitate a review of these arrangements. This issue is being considered separately as part of Ofgem’s current review of the structure of distribution use of system charges.

5.51. In relation to small generators it is clear that there are different opinions as to whether the charging principles should treat these parties differently. Ofgem/DTI’s views in respect of this specific issue are set out in its consultation document on small generators published in November 2003.
Appendix 1 List of non-confidential responses to Part 1

The following parties commented on Part 1 of the August document.

1. Association of Electricity Producers
2. BNFL Magnox Generation
3. British Energy plc
4. Centrica
5. Confederation of UK Coal Producers
6. Corus
7. EDF Energy
8. Edison Mission Energy
9. Grangemouth CHP Ltd
10. National Grid Transco
11. PowerGen
12. RWE Innogy
13. ScottishPower energy management
14. SP Transmission and Distribution
15. Scottish Renewables
16. Scottish and Southern Energy plc