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Dear Anne

Request for consent to amend the form of the Statement of Use of System Charges

Thank you for your letter of 30 March 2011 requesting that the Authority approve changes to the form of the Statement of Use of System Charges ("the Charging Statement") prepared under the terms of the electricity transmission licence (the "Licence")¹.

We note that your request is required to facilitate National Grid Electricity Transmission plc's (NGET) proposal to amend the form of the Charging Statement in accordance with paragraph 8 of standard licence condition (SLC) C4² of the Licence. Subject to our approval, the proposed document will be effective from 1 April 2011.

The Authority consents to your request. This letter briefly summarises the relevant background, the key features of NGET's proposal and sets out the reasons for the Authority's decision.

Background

Charging Statements

Under the terms of SLC C4 (2)(a) and SLC C6 (4), the licence holder is required to prepare a Statement of the Use of System Charging Methodology and a Statement of the Connection Charging Methodology and to have those statements approved by the Authority. A more detailed description of the "Charging Methodology Statements" is set out in annex 1 of this letter.

In addition, SLC C4 (2)(b) establishes that the licensee must also prepare a statement of use of system charges, calculated in accordance with the approved use of system charging methodology, and in a form approved by the Authority. SLC C4 (2)(b) also states that the statement will enable any person to make "a reasonable estimate of the charges to which he would become liable for the provision of [transmission network] services"³.

Under the terms of SLC C4 (8), NGET is required, at least once in every year, to make necessary revisions to the statements prepared in accordance with SLC C4 (2) (ie the Statement of the Use of System Charging Methodology and the Charging Statement) to

¹ Paragraph 2(b) of standard licence condition C4 ('Charges for use of system').

² This allows NGET to periodically revise the information set out in and, with the Authority's approval, alter the form of the statements prepared in accordance with paragraph 2 of SLC C4 of NGET's Licence.

³ The provision of network services by a TO (to the SO) is linked to providing transmission capability at different locations and is facilitated by the TOs building, operating and maintaining their transmission infrastructure assets.

ensure that the information set out in the statements “*shall continue to be accurate in all material respects*”.

Traditionally, NGET updates the Charging Statement around March each year to detail the charges applicable for the forthcoming financial year. In parallel, NGET has also updated certain parameters within the Charging Methodology Statements so that values calculated in line with the underlying methodology and certain example calculations reflect current values.

NGET explains that when taken together these updates provide additional transparency to industry of the parameters used within the actual charge calculation and realistic examples to aid understanding of how the charging methodology is applied.

A detailed summary of the parameters that have traditionally been updated by NGET in accordance with SLC C4 (8) is included in annex 2 to this letter.

Code Governance Review

In March 2010, we published the final proposals of the Code Governance Review (CGR)⁴. Amongst other things, these proposals suggested that the governance of network charging methodologies should be brought within the governance of the relevant industry codes.

We introduced licence changes to give effect to our final proposals⁵ which took effect on 31 December 2010. NGET subsequently raised amendment proposals⁶ to bring the Connection and Use of System Code (CUSC) into line with the applicable licence changes.

On 30 December 2010 NGET implemented CUSC Amendment Proposal 188 to bring the charging methodologies (use of system and connection) and their governance under the CUSC. As a result, a new section of the CUSC, section 14, has been created containing the Charging Methodology Statements⁷.

NGET’s proposal

NGET is seeking the consent of the Authority to amend the form of the Charging Statement prepared under SLC C4 (2)(b) in accordance with SLC C4 (8) of its Licence. Subject to our approval, the amended Charging Statement will become effective from 1 April 2011 with the intention of being routinely updated each year.

At its heart, NGET’s proposal is seeking to make an improvement to the manner in which it presents information to the wider industry. In particular, the proposal is seeking to provide additional transparency to industry of the parameters used within the actual calculation of use of system charges and aid understanding of how the charging methodology is applied.

NGET’s proposal seeks to do this by combining all the parameters that have been updated under the terms of SLC C4 (8), with the purpose of enabling users to make a reasonable estimate of use of system charges applicable under the terms of SLC C4 (2), into a single document.⁸

NGET considers that it would be appropriate for this information to be included within the Charging Statement that can be routinely updated each year. This document will be separate from the Statement of the Use of System Charging Methodology.

⁴ A copy of the Code Governance Review Final Proposals published on 31 March 2010 can be found here: http://www.ofgem.gov.uk/Licensing/IndCodes/CGR/Documents1/CGR_Finalproposals_310310.pdf.

⁵ <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=330&refer=Licensing/IndCodes/CGR>

⁶ CAP183 through to CAP188 can be found on National Grid’s website at: <http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/>

⁷ <http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/contracts/>

⁸ This information falls into three broad categories: (i) information set for the first year of a price control period and then inflated by inflation in each subsequent year of the price control period, or (ii) information set at the beginning of a new price control period and fixed for the duration of the price control period, or (iii) information set for the first year of a price control period and then revised each year to reflect the change in underlying system conditions.

We note that NGET's proposal also has an administrative impact by proposing to replace the parallel update processes that currently apply under the relevant provisions of its Licence (ie updates to the Statement of Use of System Charging Methodology and the Charging Statement) with a single process to allow efficient review and update of the information presented in the amended Charging Statement.

The key features of NGET's proposal are set out below.

TNUoS tariff calculation parameters

Amongst other things, NGET's proposal seeks to replicate the parameters currently described in the Statement of the Use of System Charging Methodology in the revised form of the Charging Statement. The information to be included within the proposed Charging Statement provides examples of parameters calculated in line with the underlying methodology utilised to calculate Transmission Network Use of System (TNUoS) levels and certain example calculations to aid the understanding of how the TNUoS charging methodology is applied. More detail on these parameters is set out in annex 2.

Balancing Services Incentive Scheme

Under the terms of its Licence⁹, NGET is allowed to recover the costs associated with activities required to keep electricity supply and demand in balance and secure in real time through the Balancing System Use of System (BSUoS) charge. The costs that NGET is allowed to recover through the BSUoS charge is subject to an incentive scheme (the Balancing Services Incentive Scheme, or BSIS scheme) to encourage NGET to undertake its actions in such a way that its total costs are at an efficient level.

NGET's proposal seeks to replicate the relevant licence parameters of the forthcoming BSIS scheme in the revised form of the Charging Statement.

Consequential changes to the Charging Methodology Statements

We note that NGET's request for consent does not seek to make equivalent changes to the Charging Methodology Statements to remove reference to information previously captured by the update process. NGET explains that the intention is to develop a separate proposal under the CUSC governance arrangements to consider changes to the Charging Methodology Statements to remove references to the information that will be updated and published in the revised form of the Charging Statement.

We note NGET's explanation that, if consent is provided, a period of time will occur when certain data examples will be published in both the Charging Methodology Statements and the Charging Statement in relation to different time periods. Specifically, the Charging Methodology Statements will provide information in relation to the charging year 2010/11, while the Charging Statement will provide this for 2011/12. We note NGET's explanation that the impact of duplication is minimal as the wording of either or both documents will highlight the period to which a specific piece of information relates.

Connection charging examples

We note that NGET's proposal does not seek to replicate the example calculations that currently feature as part of the Connection Charging Methodology Statement within the revised form of the Charging Statement.

Authority views

The Authority welcomes NGET's explanation of the proposal to amend the form of the Charging Statement.

⁹ Part 2 of special condition AA5A (Revenue restriction provision).

We note that the core underlying charging methodologies described by the Charging Methodology Statements and the way that the charges are calculated will remain unchanged as a result of this proposal.

We also note that the decision to bring the charging methodologies and their governance under the CUSC has practical implications for the process that NGET employ in updating information under the terms of SLC C4 (8). To meet this challenge NGET has developed a proposal to replace the parallel update processes that currently apply under the relevant provisions of its Licence (ie updates to the Statement of Use of System Charging Methodology and the Charging Statement) with a single process to allow efficient review and update of the information presented in the revised form of the Charging Statement.

To facilitate the proposed approach, NGET is seeking the consent from the Authority to revise the form of the Charging Statement, under paragraph 8 of SLC C4 of its Licence.

We acknowledge the views of NGET that there are practical benefits to the proposed approach. These are summarised below.

- Efficiency. NGET explains that the recent implementation of the revised code governance arrangements means that to make the necessary revisions under SLC C4 (8) would require an annual amendment to be raised under the CUSC. NGET does not believe that updating the information in this manner is an efficient use of industry resources.
- Simplicity. NGET considers that the industry utilises the parameters and examples that are updated in the Statement of the Use of System Charging Methodology in combination with the data presented in the Charging Statement. NGET considers that it is appropriate to collate and present this information in a single document.
- Transparency. NGET considers that collating and presenting the relevant information used in the actual calculation of use of system charges in a single document will improve the ability of users to analyse different charging scenarios and is consistent with transparently applying the use of system charging methodology.
- NGET also considers that the proposal facilitates competition by ensuring that up to date charging parameters remain readily available.

We agree with NGET's assessment of the practical benefits of the proposed approach.

We make the following observations on the key features of NGET's proposal.

BSIS scheme

NGET's proposal seeks to replicate the relevant licence parameters of the proposed BSIS scheme commencing on 1 April 2011 in the revised form of the Charging Statement. The BSIS scheme parameters are currently being finalised. Hence, a number of empty tables have been inserted in the BSIS section of the revised form of the Charging Statement. On completion, these parameters will be set out in NGET's licence and replicated in the revised form of the Charging Statement.

We note NGET's explanation that the tables have been included in the revised form of the Charging Statement to avoid a further request to approve the form of the document following the confirmation of the BSIS parameters for 2011/12, and to provide a view of how NGET proposes to present this information.

As noted above, we recognise that NGET's proposal is seeking to make a presentational change by seeking to combine all the parameters that have traditionally been routinely updated under the terms of SLC C4 (8) into a single document.

In addition, we acknowledge that the administrative burden placed on the industry as part of the CUSC governance process to review and update these documents will be eased by the introduction of a single update process.

Against this background, we agree with NGET's proposal to introduce a BSIS section to the text of the Charging Statement.

Consequential changes to the Charging Methodology Statements

We note NGET intends to separately progress a modification proposal under the CUSC governance arrangements to amend the Charging Methodology Statements to remove references to the information that NGET proposes to publish and update in the revised form of the Charging Statement.

We note that no explicit deadline is noted for NGET's proposed CUSC modification process. We expect a proposal to be submitted to the Authority for decision before the end of this calendar year.

Connection charging examples

We note that the statements prepared under the terms of SLC C4 (2), and updated in accordance with SLC C4 (8), do not apply to charges determined in accordance with the Statement of the Connection Charging Methodology.

Furthermore, we note that there is no provision equivalent to SLC C4 (8) in relation to connection charges or an equivalent obligation on the licence holder to prepare a "Charging Statement" for connection charges determined in accordance with the connection charging methodology. Instead, a separate requirement exists under the terms of SLC C6 (12) that requires NGET to, where practicable, include examples of the connection charges likely to be made in different cases as determined in accordance with the methods and principles shown in the statement prepared under SLC C6 (4).

We note that NGET's request for consent does not seek to replicate the example calculations that feature as part of the Statement of the Connection Charging Methodology within the revised form of the Charging Statement.

We note NGET's explanation that it separately intends to consider the appropriateness of several connection examples contained in the Statement of the Connection Charging Methodology which will, without annual CUSC amendments, become out of date over time. We acknowledge that such a process may result in a request to alter the Licence to facilitate their movement to a document outside of the CUSC governance arrangements.

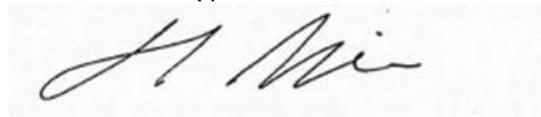
We encourage NGET to develop an appropriate modification under the CUSC governance arrangements and expect a proposal to be submitted to the Authority for decision before the end of this calendar year.

Authority's decision

The Authority approves your request to amend the form of the Charging Statement in accordance with paragraph 8 of SLC C4 of the Licence in the manner set out above.

I would be happy to answer any queries you may have with respect to the Authority's decision.

Yours sincerely,



Hannah Nixon
Partner, Smarter Grids & Governance
Duly authorised on behalf of the Authority

Annex 1 - The Charging Methodology Statements

Under the terms of SLC C4 (2) of its Licence, NGET is required to prepare a statement of the use of system charging methodology. The Statement of the Use of System Charging Methodology sets out the basis upon which it will charge for use of the National Electricity Transmission System (NETS)¹⁰. The statement is split into two sections:

- i. the Transmission Network Use of System (TNUoS) charging methodology. This describes the methods and principles that NGET, in its role as system operator (SO) of the NETS, employs to levy charges for use of the NETS on behalf of the Transmission Owners (TOs)¹¹; and
- ii. the Balancing Services Use of System (BSUoS) charging methodology. This describes the methods and principles that NGET (in its role as SO) employs to levy charges on users of the NETS to recover the costs it incurs in the procurement and utilisation of energy and system balancing services.

Under the terms of SCL C6 (4) of its Licence, NGET is required to prepare a statement of the connection charging methodology. The Statement of the Connection Charging Methodology describes the methods and principles that NGET (in its role as SO) employs to levy charges on users for connection to the NETS.

The Authority's approval power in respect to the Charging Methodology Statements applies only to the method by which the charges are determined¹² and the form of the statements; we do not set or approve the level of individual charges.

Changes to the charging methodologies set out in the above statements are subject to a veto by the Authority. SLC C5 (1) and SLC C6 (2) establish that the licensee must keep the use of system charging methodologies at all times under review. In turn, SLC C5 (2) and SLC C6 (3) establish that the licensee may make modifications to the charging methodologies, for the purpose of better achieving the relevant objectives as set out in SLC C5 (5) and SLC C6 (11), respectively.

There have been no changes proposed to the form of the Charging Methodology Statements or the Charging Statement since their original approval in April 2005¹³.

¹⁰ The NETS was extended into offshore waters on 2 March 2011 to coincide with the financial close and concluded electricity transmission licence grant process for the Robin Rigg offshore project. Onshore, the NETS consists of three transmission licence areas which are defined as England and Wales, South of Scotland and North of Scotland.

¹¹ There are currently four TOs. Onshore, NGET owns the England and Wales transmission system, Scottish Power Transmission Ltd owns the network in the South of Scotland and Scottish Hydro Electric Transmission Ltd owns the network in the North of Scotland. Offshore, TC Robin Rigg OFTO Ltd hold an OFTO Licence to operate the transmission link from the Robin Rigg wind farm to the onshore grid.

¹² Following an extensive consultation process the Authority approved NGET's Connection methodology proposals in December 2004 and its BSUoS methodology proposals in February 2005. The Authority approved NGET's TNUoS methodology proposals on 6 April 2005.

¹³ http://www.nationalgrid.com/NR/rdonlyres/9E7AAB45-847E-4FF6-B657-3DD8E44B238A/3529/11049_11305.pdf

Annex 2 – Update parameters

The TNUoS charging methodology statement

- The expansion constant applied by NGET in the calculation of TNUoS tariffs. This is set for the first year of a price control then both increased by inflation in each subsequent year of the price control period.
- The onshore wider and local expansion factors applied to various types of onshore circuit in the calculation of TNUoS tariffs. These are amended annually to reflect the change in expansion constant.
- The reference node applied by NGET in the calculation of TNUoS tariffs. This is updated annually.
- An annuity factor applied by NGET in the calculation of the expansion constant. This factor is recalculated at the start of a price control period.
- An overhead factor applied by NGET in the calculation of the expansion constant. This is recalculated at the start of each price control period.
- The offshore civil engineering discount provided to the offshore substation tariff to reflect the average cost of civil engineering for onshore substations. This is inflated by RPI each year.

The BSUoS charging methodology statement

- BSIS parameters applied in the recovery of costs associated with its SO activities through the BSUoS charge. These are set as part of the BSIS process.

The Statement of Use of System Charges

- Schedule of TNUoS Wider zonal generation charges (£/kW), updated annually.
- Schedule of TNUoS Local generation substation charges (£/kW), updated annually.
- Schedule of TNUoS Local generation circuit charges (£/kW), updated annually.
- Schedule of TNUoS Short Term TEC (£/kW) and Limited Duration TEC (£/kW per week), updated annually.
- Small generators' discount under SLC C13. This value is updated annually.
- Schedule of TNUoS Demand charges (£/kW) and energy consumption charges (p/kWh), updated annually.
- Zonal maps, updated annually to reflect entry and exit of demand and generation on the system.
- Application fees payable in respect of applications for new connection agreements, certain use of system agreements and modifications to existing agreements, updated annually.
- Charge out rates for engineering charges for variable price applications, updated annually.

More detail on each of the above parameters can be found on NGET's website:
www.nationalgrid.com.