Modification proposal:	**Connection and Use of System Code (CUSC) CMP192: National Grid proposal for enduring user commitment arrangements (CMP192)**		
Decision:	The Authority[1] directs that the Workgroup Alternative CUSC Modification (WACM) proposal 5 be approved[2]		
Target audience:	National Grid Electricity Transmission PLC (NGET), parties to the CUSC and other interested parties		
Date of publication:	30 March 2012	Implementation Date:	30 March 2012[3]

Background to the modification proposal

When a generator applies to connect to the transmission system or to increase its existing capacity, Transmission Owners (TOs) undertake the required reinforcement works to the electricity network to accommodate its needs. However, the generator may decide to cancel its project or reduce its capacity. Where the associated works have already begun and the capacity cannot be reused, this can result in unnecessary costs for wider network users and ultimately for consumers. Similarly, where an existing generator is reducing its capacity or closing, if the TO does not get sufficient notice it may incur costs that could otherwise have been avoided. User commitment places liabilities on users in order to financially secure the cost of investment works or ensure otherwise avoidable costs are not incurred.

User commitment arrangements currently in place have evolved over recent years and differ between generators already connected (post-commissioning) and those expected to connect to the network (pre-commissioning)[4]. Post-commissioning generators are currently not liable for user commitment. They need to provide one year and five days' notice in order to reduce their capacity or close[5]. Pre-commissioning generators are liable to provide financial security for the period from signature of a connection agreement until commissioning. They can choose between two currently available methodologies. The generator can underwrite the actual attributable costs (Final Sums methodology) or a generic liability (Interim Generic User Commitment)[6]. The existing arrangements for pre-commissioning generators were introduced on a temporary basis and are set to expire on 1 April 2012. They are not referred to in the CUSC and as such are neither well documented nor subject to robust industry governance.

National Grid Electricity Transmission (NGET) reviewed the arrangements for the two sets of generators and raised a proposal for enduring arrangements through CUSC Amendment Proposal 131 (CAP 131) in September 2006[7]. The Authority rejected CAP131 on 13 October 2008. We considered that the proposed arrangements did not

[1] The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.
[2] This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.
[3] There is a twelve month transition period from the current arrangements with the amendment proposal taking effect from 1 April 2013.
[4] A generator already connected but seeking to increase its existing capacity would be treated as pre-commissioning for the purposes of user commitment in such circumstances.
[5] Shorter notice would incur a year's TNUoS charge in addition to charges for the current year.
[6] Exceptions to this are offshore connections where liabilities are currently calculated using the Final Sums methodology only.
[7] The CAP131 proposal and related documentation, including the decision letter from the Authority, can be found at: http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/amendment_archive/

adequately consider potentially undue discrimination[8] between the two sets of users.

Existing arrangements were cited as a barrier to entry by many smaller parties, during the scoping phase of project TransmiT[9]. In response to those concerns and the inconsistencies present within the existing arrangements and their interim nature, we requested NGET to engage with the industry to develop enduring user commitment arrangements.

The modification proposal

In February 2011, NGET proposed CUSC Modification Proposal (CMP) 192. The proposal was further developed by the industry and submitted to us in November 2011 for our consideration[10]. CMP192 and its alternatives propose new arrangements for calculating user commitment liabilities, and associated securities, for both pre and post-commissioning generators. The proposer believes that CMP192 addresses the inconsistencies present in the current arrangements and delivers a cohesive approach for both sets of generators. The proposal seeks to add a new section to the CUSC to establish an enduring regime. By including the arrangements in the CUSC, the proposer considers that CMP192 would better facilitate the Applicable CUSC Objectives (a) and (b)[11] as it would provide more transparency and clarity on the methodology for estimating liabilities and the amount required from users.

Original CMP192 proposal

CMP192 proposes that the **user commitment period** be based on the notice period that TOs reasonably require to change investment plans with the lowest practicable cost impact. NGET determined that this optimum notice period is four years, based on the analysis of the TOs' historical investment spend profiles[12]. Under the original proposal, four years is the proposed commitment period for both pre and post-commissioning generators. The proposer believes that a four-year user commitment for both sets of generators would lower the risk of inefficient investment by incentivising timely provision of information to the TOs and would thus better facilitate Applicable Objective (a).

As with the current arrangements, a pre-commissioning generator's liability more than four years prior to commissioning (advanced works) increase annually from £1/kW to a maximum of £3/kW[13]. Within four years prior to commissioning, pre-commissioning generators will assume a wider and local liability as set out below.

CMP192 assumes that **local works** investments can be directly attributable to a limited number of generators, whilst **wider works** are difficult to disaggregate and apportion due to the nature of the system and other factors, including demand security. The proposal makes a small number of generators liable for those local works which can be directly attributed. All generators retain a liability for wider transmission network

[8] In this context, undue discrimination is the treatment of relevantly similar parties differently or relevantly different parties in the same way without objective justification.
[9] Project TransmiT is Ofgem's independent and open review of transmission charging and associated connection arrangements. More details can be found on the Ofgem website: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=1&refer=Networks/Trans/PT
[10] For Final Modification Proposal, please see: http://www.nationalgrid.com/NR/rdonlyres/DA4EB7E8-7168-49CA-A115-381A3A5D9753/50218/CMP192finalCUSCModificationReport10.pdf
[11] As set out in Standard Condition C10(1) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=5327
[12] The rate of change of increase in spend for TO investments is analysed and results presented in the Final Modification Proposal, page 20.
[13] This liability is not linked to either the attributable or wider liability values as defined later in this letter.

investment, whilst only pre-commissioning generators retain a liability for local works. Both local and wider liabilities increase over a four-year user commitment period. This reflects the fact that the risk of inefficient investment increases as the level of notice decreases and is intended to encourage generators to give as much notice as possible.

In calculating local and wider liabilities, the proposed methodology includes a number of **reduction factors** in order to more accurately reflect the risk to the TOs and to avoid over-securitisation of assets. The reduction factors for wider works are -

- *Risk sharing with consumers.* CMP192 proposes a 50/50 sharing of wider investment risk between generation and demand. This is on the basis that generation and demand both benefit from, and drive, wider transmission investment equally and that the risk of such wider investment being inefficiently incurred should be shared[14].

- *Asset reuse by TOs.* When a generator cancels its project and an investment is no longer required, the TO might be able to reuse a certain proportion of those assets. The generic asset reuse factor was proposed for wider works and a specific factor determined by the TO for local works as set out further below.

- *Catch-up investment due to the Connect & Manage initiative.* Wider works liabilities are reduced for generators connected in advance of works required to restore compliance of the system with the Security and Quality of Supply Standard (SQSS) as the transmission investment is still required to meet SQSS fault level compliance.

Unlike wider liability, where generators secure 50% of the work, generators are liable for 100% of the local works they are driving. The proposal assumes that local transmission system assets are less likely to be used following termination by a generator which prompted the works. The liability for local works is reduced by -

- A Local Asset Reuse Factor, accounting for the assets being constructed for that generator which the TO could potentially reuse on another project, and

- A Strategic Investment Factor, which applies in the event that a TO builds greater capability than is required for the generation connecting to that asset.

The proposal **separates user commitment liability from the required security** in order to better reflect the risk of the liabilities being drawn-down. CMP192 dramatically reduces the security requirements for pre-commissioning generators[15]. The proposal contains a three-stage reduction based on whether a developer has achieved key consents. Prior to four years before the commissioning date, the required securities would be 100% of the liabilities. Within four years of the commissioning date, but prior to the key consents being granted, securities are set at 42% dropping to 10% after the consents are in place.

Alternative proposals

As a response to the original proposal, the industry Workgroup developed a broad range of alternative proposals in response to various concerns raised by the members. The basic methodology behind the original proposal set out above is the same for all alternatives apart from the following aspects:

[14] For demand, this benefit includes greater reliability and improved access to competitive generation sources.
[15] Post-commissioning generators are currently not liable to post security and are thus not affected by the proposal.

- Three options have been proposed for the **user commitment period**:
  - retain the four-year commitment period for pre and post-commissioning generation as per the original;
  - reduce both pre and post-commissioning user commitment to two years for wider works and retain the local liability at four years; or
  - reduce only post-commissioning user commitment to two years.
- **Grandfathering**, the option would allow existing pre-commissioning users to remain on their existing arrangements until they connect.
- The option to **reduce the pre-commissioning generators' liability to 50% of the local works** where they can be shared with demand.

All alternatives provide the option for pre-commissioning generators to replace the generic £1,2,3/kW amount for advanced works with a specific, cost reflective liability.

The following table depicts the main features of the twelve Workgroup Alternative CUSC Modification (WACM) proposals.

Notice period	**Pre:Post 4:4**				**Pre:Post 4:2**				**Pre:Post 2:2(local 4)**			
WACM proposal	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**
Generic/cost reflective advanced works	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Grandfathering			✓	✓			✓	✓			✓	✓
Local works sharing 50%		✓		✓		✓		✓		✓		✓

Transition from the current arrangements

Under CMP192, there would be a twelve month transition period from the current arrangements until the enduring arrangements take full effect from 1 April 2013. During the transition period, the current agreements would be extended so that any difference between efficiently incurred costs and costs secured by prospective users are recoverable by the TOs.

As part of CMP192, NGET proposed to send revised user commitment agreements and notices to network users by September 2012. Under the proposal and its alternatives, existing commissioned generators who do not wish to move to the new arrangements, would need to provide notice within six months of the implementation date (end of September 2012) of closure within four years of the implementation date (end of March 2016). Likewise, all connection offers which would take effect from the proposed go-live date (April 2013) would by default be on the new arrangements.

CUSC Panel[16] recommendation

The CUSC Modification Panel considered the Final Modification Report (FMR) and voted on the original and the alternative proposals at its meeting on 11 November 2011. The Panel voted unanimously that the original and all twelve alternatives were neutral against Applicable Objective (c)[17]. The Panel voted by majority that WACMs 5 to 8 and 11 and 12 would better facilitate Applicable CUSC Objectives (a) and (b). There was no Panel majority support for the original or any of the WACMs as 'best' meeting the Applicable Objectives. However, WACM 8 (four and two-year notice, local works sharing and the option to grandfather) had a marginally higher number of votes compared to the other five options considered to better facilitate Applicable Objectives (a) and (b)[18]. The views of Panel members are set out in full in the FMR.

Impact assessment and consultation

In accordance with the principles set out in section 5A of the Utilities Act 2000 (Duty to carry out an Impact Assessment), we have carried out an Impact Assessment and consulted on it on 13 February 2012[19]. We presented our assessment and our developing thinking on the original proposal and its alternatives. We recognised that the proposal would reduce barriers to entry by significantly reducing the security obligations placed on pre-commissioning generation.

Our analysis indicated that, on aggregate, liabilities for pre-commissioning generators would remain roughly the same under CMP192. We noted the redistributive effects but concluded that liabilities under CMP192 better reflect the risk of inefficient investment posed by a generator failing to connect. We set out our view that a four-year liability is appropriate for pre-commissioning generators.

We used the consultation to form a view on the most appropriate period for post-commissioning generators. Whilst acknowledging the value to the TOs, and ultimately consumers, of a four-year notice period in lowering the risk of inefficient investment, we considered various factors that may have an impact on generators' ability to provide such notice. We acknowledged that a number of developing policies, particularly elements of Electricity Market Reform (EMR) and our liquidity proposals, are likely to have an impact on generators' decision on whether and for how long to remain operational. We also acknowledged that asset health and the associated plant life assessment could hinder generators in providing a four-year notice. Our Impact Assessment presented an analysis undertaken by NGET to quantify the benefits of a four-year commitment for post-commissioning generators. We commented that the analysis might overestimate the benefits associated with a longer notice regime.

We did not consider there to be anything wrong with an appropriate portion of the liabilities for local works being shared with demand. However, we considered the proposal to be too broad and insufficiently developed.

We expressed a concern about the additional operational burden associated with

[16] The CUSC Panel is established and constituted from time to time pursuant to and in accordance with the section 8 of the CUSC.
[17] Applicable CUSC Objective (c) is "compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency".
[18] WACM 8 received 3 out of 8 votes, whilst WACM 11 and 12 received 2 votes each and WACM 10 received one vote as best meeting the Applicable Objectives. The remaining WACM received no votes as better facilitating the Applicable CUSC Objectives.
[19] http://www.ofgem.gov.uk/Licensing/ElecCodes/CUSC/Ias/Documents1/CMP%20192_master_9.pdf

grandfathering and the cost that would be placed on NGET in implementing several regimes in parallel. In light of this concern, the lack of clarity over a number of elements of this proposal, and our consideration that all pre-commissioning generators are likely to benefit from the reduced securities proposed, we did not consider grandfathering would be appropriate.

The Authority's decision

We have considered the issues raised by the modification proposal and the FMR dated 22 November 2011. We have considered and taken into account the responses to the Workgroup and Code Administrator consultations on the modification proposal and alternatives which are attached to the FMR[20] and responses to our impact assessment and consultation.

The Authority's decision is that:

1. **The original modification proposal would not better facilitate the achievement of the Applicable CUSC Objectives[21];**
2. **WACMs 1 to 4 and 6 to 12 would also not better facilitate the achievement of the Applicable CUSC Objectives;**
3. **WACM Proposal 5 would best facilitate the achievement of the Applicable CUSC Objectives; and**
4. **Directing that the WACM Proposal 5 be approved and implemented is consistent with the Authority's principal objective and wider statutory duties[22].**

Reasons for the Authority's decision

The following sections set out our assessment of the original proposal and its alternatives against the Applicable CUSC Objectives. We considered whether the original and each of the aspects featured in the alternative proposals better facilitate the achievement of the Applicable CUSC Objectives. We consider that -

- Objective (a): the efficient discharge by National Grid of the obligations imposed on it by the Electricity Act 1989 and its Transmission Licence, and

- Objective (b): facilitating effective competition in the generation and supply of electricity and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity

are relevant to our decision and that the original and the alternatives are neutral with regard to CUSC Objective (c) compliance with the Regulations and any relevant legally binding decisions of the European Commission and/or the Agency for the Co-operation of Energy Regulators. In making our decision, we have considered the arguments presented by the proposer, stakeholders and respondents to our consultation. These are

[20] CUSC modification proposals, modification reports and representations can be viewed on NGET's website at http://www.nationalgrid.com/uk/Electricity/Codes/systemcode/amendments/
[21] As set out in Standard Condition C10(1) of NGET's Transmission Licence, see: http://epr.ofgem.gov.uk/document_fetch.php?documentid=5327
[22] The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Gas Act 1986, the Electricity Act 1989 and the Utilities Act 2000, all as amended.

highlighted throughout the following sections where relevant. All non-confidential responses have been placed on the Ofgem website[23].

We consider that the underlying methodology that forms the basis of the original and all alternatives would allocate the liabilities to generators in a manner reflective of the risk that any changes in their plans would pose to efficient transmission investment. Such risk-reflective liabilities would protect the interests of consumers by reducing the risk of inefficient investment and would better facilitate Applicable Objective (a). Our decision is therefore consistent with our principal objective of protecting the interests of consumers.

We agree with the proposer and the industry that CMP192 would better facilitate Applicable Objectives (a) and (b) by codifying the arrangements and reducing security respectively. We note that those features are common to the original and all its alternatives. We consider that an enduring regime, codified under industry governance, whereby generators are incentivised to provide information on their future connection and use of system requirements, would better facilitate the development of an efficient co-ordinated and economical transmission system. In our view, reduced but still risk reflective securities would better facilitate Applicable Objectives (a) and (b). The proposal would reduce barriers to entry for smaller, independent generators by significantly reducing the security obligations placed on pre-commissioning generators. We consider that this would better facilitate effective competition in generation and supply of electricity. We also consider that the security based on an assessment of the likelihood of cancellation and closure better reflects the risk associated with generator's liabilities and it would thus better facilitate Applicable Objective (a). We acknowledge the arguments presented by some parties in relation to the differentiation in the existing credit cover arrangements on the basis of a company's credit rating. We consider that this approach provides valuable protection to consumers against the risk of a generator defaulting and we do not consider them to be discriminatory.

Different treatment for pre and post-commissioning generators

We welcome the level of consideration given by the Workgroup to the issue of discrimination, particularly in the way liabilities for wider works are applied to pre and post-commissioning generators. We are grateful to the Workgroup for presenting us with the option to treat them both the same by placing either a four or a two-year user commitment on each. We understand the argument presented by the proposer and some Workgroup members that signals received from pre and post-commissioning generators are equally important in developing the network efficiently. However, we consider that the signals from the two sets of generators will not have the same impact on network planning –

- For pre-commissioning generators, user commitment is the only signal available to the TOs of their intention to connect whilst there are a number of other signals available to indicate whether a post-commissioning generator is likely to reduce its capacity or close[24].
- The time horizons over which decisions to invest in new plant or to continue operating existing plant differ significantly. For post-commissioning generators, it may be difficult to decide whether to continue operating over a four-year period due to uncertainty over its continued ability to operate or due to asset health, changes in regulatory policy and future fluctuations in commodity prices.

[23] http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=106&refer=LICENSING/ELECCODES/CUSC/IAS
[24] Its levels of operation may be decreasing or it may be approaching the end of its asset life.

Given different drivers behind decisions to connect new generation to the transmission system, and decisions on how long to keep existing plant open, we consider that it would not be unduly discriminatory to treat pre and post-commissioning generators differently.

User commitment period

NGET believed that a four-year commitment for both pre and post-commissioning generators, as per the original proposal, would lower the risk of inefficient investment by incentivising timely provision of information. Most Workgroup members and respondents to our consultation thought that four and two-year user commitment for pre and post-commissioning generators respectively would provide a fairer balance between the information available to the respective parties. Some, including NGET, had concerns regarding different treatment of pre and post-commissioning generators and its impact on effective competition. Most respondents to our consultation were concerned about the risks associated with a four-year commitment for post-commissioning generators. They warned that it would increase barriers to exiting the market and would be detrimental to competition. It was most respondents' view that NGET's assessment of the associated benefit of moving post-commissioning generators to a four-year regime did not support the case.

We consider that NGET's analysis has not justified the benefit associated with placing a four-year user commitment on post-commissioning generators and has thus not demonstrated that the four-year notice would better facilitate Applicable Objective (a). We consider that asset health, and the associated plant life assessment, could impact a generator's ability to provide a four-year notice. We are also mindful of a number of generators' concerns that they would not be able to commit to a four-year notice until a number of areas of regulatory uncertainty have been resolved. We are concerned that the uncertainty generators would face in committing to a four-year notice could lead to inefficient decisions; it could cause generators to exit the market or it could prevent entry for new generators. This could either harm or distort competition. Given that it has not been demonstrated that a four-year notice would better facilitate Applicable Objective (a), and due to our view that it would not be unduly discriminatory to treat the two sets of generators differently, we consider that it might be detrimental to Applicable Objective (b) to place a four-year commitment on post-commissioning generators. It is therefore our view that, at this time, it is not appropriate to approve the original and any of the alternatives with a four-year notice for post-commissioning generators and that a two-year user commitment is appropriate.

We acknowledge that a four-year user commitment for post-commissioning generators would in principle allow NGET and other TOs more time to efficiently plan the development of the system. We consider that NGET should report on costs that would have been avoided had a four-year user commitment for post-commissioning generators been in place. If there is evidence that material costs would have been avoided if post-commissioning generators provided longer notice, we would expect NGET and other TOs to consider the merits of a modification to alter the arrangements accordingly.

We consider that it has been demonstrated that a four-year liability for local works, which only pre-commissioning generators are liable for, would align with the typical TO capital expenditure profiles for such work thereby better facilitating Applicable Objective (a). Our impact assessment has shown that the magnitude of the local liability is far greater than that of the wider liability, by a factor of almost 10[25]. Shortening the duration of the

[25] See Table 3 in Chapter 3 of our Impact Assessment.

wider works liability for pre-commissioning generators to two-years, as proposed in WACM proposals 9 through 12, is likely to have little material impact on liabilities three to four years prior to connection. Given our view that it would not be unduly discriminatory to treat the two sets of generators differently, we consider that a four-year notice is appropriate for local and wider works for pre-commissioning generators. We believe our decision to be proportionate to the risk of inefficient investment the two sets of generators pose to consumers.

Choice between the generic and cost reflective local works liability

The Workgroup members, the proposer, and the respondents favoured this choice being available in all of the alternatives. They recognised that the option would improve flexibility of the arrangements and would enable projects in the early stages of development to better manage project risks.

We agree that the choice between the generic and cost reflective liability for the advanced works would improve the flexibility of the arrangements. For that reason, we consider that it would better facilitate the development of an efficient co-ordinated and economical transmission system and would better facilitate Applicable Objective (a). Equally, the option would offer useful choice to developers in forecasting their liabilities. We consider that this could reduce barriers to new generation and improve competition and hence would better facilitate Applicable Objective (b).

50:50 local works sharing with demand

The Workgroup members, NGET and respondents to our consultation supported the principle of local works sharing with demand. However, a majority of respondents recognised that the proposal was not sufficiently developed with some arguing that the proposed 50% sharing was not justified. Most recognised that this aspect of the arrangements could be dealt with post implementation and would welcome and support a timely new proposal to consider it.

We understand that in almost all such cases the portion of the local works that are designed to accommodate demand is likely to be significantly less than 50%. Consequently, we consider that this aspect of the proposal is extremely broad and it could be interpreted in a number of ways. We have concerns that it could potentially be subject to gaming by generators attempting to halve their local liabilities through demonstrating that a portion of their local works accommodates demand. We consider that implementing it in such form would place a disproportionate risk on consumers and wider transmission users. For those reasons, we consider that this aspect of the proposal does not better facilitate Applicable Objective (a).

We understand the concerns of generators located in remote locations as the liabilities they are currently being asked to secure are large. However, this is a direct result of the considerable amount of transmission investment required to connect them. We note that under the enduring arrangements, all pre-commissioning generators, including those located in remote locations, will benefit from the upfront reduction factors as well as significant reduction in securities. We are not against the principle of local works sharing and we encourage the industry to develop the principles behind this proposal further.

Grandfathering

A number of Workgroup members and respondents to our consultation supported the option to grandfather existing arrangements for pre-commissioning generators. They noted that it would better facilitate competition as it would minimise the disruption caused by implementation of the proposal. They were mainly concerned about potential re-opening of the financial arrangements and the cost that might incur. A number of respondents to our consultation acknowledged the additional complexity and administrative burden associated with grandfathering and pointed to the improvements in security arrangements that all pre-commissioning generators would benefit from under CMP192. NGET acknowledged the value for generators close to commissioning but noted discrepancies that might arise in the future due to maintaining similar parties on different arrangements. It further considered that the option was not well defined.

We acknowledge that a stable regulatory climate is important in attracting required investment in an efficient manner. Stable and predictable user commitment liabilities are important for investors and we understand the arguments presented to us for allowing the grandfather existing generators. However, we have supported the current arrangements on an interim basis only. We consider that the methodology for user commitment under CMP192 better reflects the risk of inefficient investment compared to the current arrangements and it would thus better facilitate Applicable Objective (a). We consider that it would not be appropriate to defer its implementation for some generators. In addition, we do not consider it appropriate for NGET to administer three regimes in parallel; this would not meet the criteria of efficient discharge of its licence obligations and would thus be contrary to Applicable Objective (a). Finally, we note that pre-commissioning generators will benefit from significantly reduced securities which they would not be entitled to under the grandfathering arrangements.

Decision notice

In accordance with Standard Condition C10 of NGET's Transmission Licence, the Authority, hereby directs that the alternative modification proposal WACM 5 of the CMP192 'National Grid proposal for enduring user commitment arrangements' be made.

Ian Marlee

Senior Partner - Smarter Grids & Governance: Transmission
Signed on behalf of the Authority and authorised for that purpose