



This newsletter provides a brief update on the key electricity market design changes currently being progressed within Great Britain, focusing on February 2005.

The newsletter aims to assist electricity market participants who already have a good broad understanding of the GB electricity trading arrangements, and the key documents that underpin them, to keep track of the major consultations that affect the development of the wholesale electricity market.

This issue covers: Ofgem consultations; BETTA; publications/announcements by a number of government and other bodies; Transmission charging issues; and the BSC and CUSC Modifications and related matters.

If readers need further information on any of the issues raised in this briefing note, or would like advice on how these changes might affect their companies, please contact IPA Energy Consulting on 0131 240 0840.

HEADLINES

- The BETTA Go live date was confirmed as 1 April 2005.
- The EU has indicated that it does not consider that the UK's allowances should exceed the 736 million proposed in the UK's draft NAP, submitted in April 2004. This leaves a shortfall of 20 million allowances compared to the total included in the revised NAP submitted in November (756 million). Government has announced its intention to launch a legal challenge to the EU's view. In the meantime allowances will be issued in accordance with the lower figure, with the shortfall being recovered from the generation sector.
- It is understood that there will be a delay in the introduction of the right of appeal to the Competition Commission on Ofgem's decisions on Code Modifications.
- The DTI has published its first consultation on the 2005/6 review of the Renewables Obligation.
- The BSC's Performance Assurance Board is to publish peer comparison tables on the performance of suppliers against two performance standards. The first performance period to be reported will April 2005 and first publication will be some time after 14 June.

Ofgem Issues and Consultations

NGC System Operator incentive scheme from April 2005 Final Proposals and statutory licence consultation

On 1 March, Ofgem published its final proposals for the GB system operator incentive to apply from 1 April 2005, together with the statutory consultation on the changes to NGC's licence that are needed to give effect to it. The document also contains a summary impact assessment. Comments on the licence changes were requested by **29 March**.

The main elements of the scheme are summarised below.

- The scheme runs for one year from 1 April 2005.
- The scheme covers all NGC's "external costs" (i.e. the total cost of operating the system excluding its own internal costs) and the net cost of transmission losses (i.e. the difference between the actual volume of transmission losses on the system and a target volume, priced at an assumed value of £29/MWh). Previous schemes have been based on the total volume of transmission losses.
- The incentive target costs are £377.5m. This is equivalent to £500m under a scheme based on gross losses.
- The sharing factors are asymmetric, with NGC able to keep 40% of any savings against the target cost and being unable to recover 20% of any costs in excess of the target level.
- The maximum profit to NGC is capped at £40m and the maximum loss at £20m.
- There is provision for profiling the scheme in the event BETTA go-live is delayed.
- There is provision for the scheme to be reopened for "Income Adjusting Events" (IAEs) to deal with unanticipated outcomes. However IAEs will not be allowed in the event of identified BSC Modifications and CUSC Amendments being implemented – this is essentially all current mods and amendments except BSC Mods P173 (Alternative) and P175 and CUSC amendment CAP076 (Alternatives).



- In addition, the document notes that the IAE provisions may also be triggered if the costs associated with CAP047 differ, materially, from the allowance of £7.35m that Ofgem has included in the incentive scheme target.
- The final proposals also set the sharing factors for the *internal* SO incentive scheme to 40% and 20% in line with the proposals for the external scheme.

The final proposals and statutory consultation can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10404_6505.pdf

Modification of NGC's transmission licence - Explanatory note pursuant to NGC's SO incentive Scheme from April 2005 and Directions

On 31 March, Ofgem published a note setting out the changes being made to NGC's licence to give effect to the 2005/6 SO Incentive Scheme, including amendment of "a minor textual error"

and the direction, issued on 30 March, giving effect to the changes. The note can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10983_10705a.pdf,

and the directions at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10982_10705b.pdf

The provision of non-contestable connection services by DNOs: Amending Licence Condition 4C of the Electricity Distribution Licence

On 2 March, Ofgem issued a consultation on amending the provisions of the electricity distribution licence, in particular, licence condition 4C – (Non Discrimination in the Provision of Use of System and Connection to System) to better facilitate competition in the provision of connections.

The document can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10411_6805.pdf

Distributed Generation Incentive Innovation Funding Incentive Registered Power Zones Regulatory Instructions and Guidance Version 1

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Electricity Distribution Price control revenue reporting: Regulatory Instructions and Guidance (version 1)

On 3 March, Ofgem published its first versions of the rigs (regulatory instructions and guidance) for the distributed generation innovation funding incentive (IFI), registered power zones (RPZs) and price control revenue reporting.

The rigs for the IFI and RPZs can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10451_7105.pdf

The rigs for revenue reporting can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10450_7005.pdf

Energy Efficiency Commitment 2005-2008 Technical Guidance Manual Issue 1

On 15 March, Ofgem published the first edition of its technical guidance on the EEC, which can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10651_8305.pdf

Gas and electricity licence applications Guidance document

Also on 15 March, Ofgem published its updated guidance on applying for gas and electricity licences (and the procedures Ofgem will follow when it proposes to refuse an application).

The Guidance can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10659_8605.pdf

Revised licence fee cost recovery principles

On 18 March, Ofgem published a consultation on revising the principles which are used to set the "relevant proportion" of Ofgem's costs to be recovered from a licensee under the standard licence conditions in the gas transportation and electricity distribution and transmission licences. The consultation covers the impact on the principles of four issues, which are summarised below.

- Competition Commission costs

No changes to the principles are proposed to deal with appeals where Ofgem is required to pay the Commission's costs or appellant's costs as these will form part of Ofgem's "normal running costs".

For licence modification references, changes are required to all forms of licence to enable Ofgem to comply with any directions from the Competition Commission as to how its costs



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should be recovered, or to treat such costs as part of its normal running costs where no direction is issued. The consultation indicates that, subject to comments received, the Secretary of State is expected to make these licence changes later this year.

- **BETTA**

There is to be no change to the proportion of Ofgem's costs to be recovered from the different types of licensee (the allocation of the electricity fee will continue to be split 50:50 between distribution and transmission licensees). However, changes are required to the principles to accommodate the decision that all of the transmission licensees' share of these costs will be recovered from the GB System Operator under BETTA.

- **Ofgem's 5 year RPI-X regime**

Ofgem is proposing changes to the principles to allow any under or over recovery in any one year to be rolled forward to the next, within the five year period. This is subject to a £3m cap on underspend, such that any underspend in excess of the cap could not be carried forward but would be returned to licence fee payers in the following year. This change may lead to year on year deviations to the RPI-X profile of expenditure but is not intended to affect the total income to be recovered under the RPI - X regime in the five year period. Any savings (underspend) for the period would be repaid in year six.

The consultation also indicates that where Ofgem is required to undertake unplanned activities, Ofgem would present a case for additional funding to the Audit Committee who would consult Ofgem's internal auditors and present a case to HM Treasury for an increase. If approved, this would be recovered from licensees. However, any underspend would be used first to offset the increase in licence fees.

- **Update of text**

The consultation indicates that a number of changes have been made to the text of the principles to bring them up to date.

The consultation indicates that Ofgem intends to implement the changes to the principles for the year commencing 1 April 2005. Comments are requested by **4 May**.

The consultation, which includes a revised draft of the principles, can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10681_8705.pdf

Application of Section C licence conditions for Independent Distribution Network Operators

Also on 18 March, Ofgem published an open letter consulting on extending the scope of three licence conditions for ex PES distribution network operators (DNOs) that currently only apply within their distribution services area (the area covered by the original PES licence) and introducing equivalent licence conditions into the licences of independent distribution network operators (IDNOs). The affected licence conditions are in Section C of the standard conditions which is not currently switched on in the licences of the IDNOs and only applies within the distribution services area of DNOs. They are:

- **SLC 34** – Compulsory Acquisition of Land etc;
- **SLC 35** – Other Powers etc; and
- **SLC 48** – Last Resort Supply: Payment Claims.

Ofgem suggest that these three licence conditions should apply on a GB basis to all licensed distribution network operators.

Ofgem suggest three possible ways of implementing this change but the letter states that their preferred approach is to undertake a collective licence modification to modify SLCs 34, 35 & 48 and introduce new conditions into Section B of the distribution licence such that they apply equally to all licensed distribution network operators.

The deadline for comments is **29 April**. The consultation can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10683_8805.pdf

Preventing Debt and Disconnection - the Review An independent review by Sohn Associates

On 22 March Ofgem, on behalf of itself and Energywatch, published an independent consultant's report on the progress made by the six main energy suppliers in implementing its good practice guidelines on debt prevention and management, that were first published in January 2003.

The report's summary states that the publication of the guidelines has had a positive impact but much remains to be done. It summarises the progress of different companies in implementing the guidelines as follows.....

“EDF Energy and Scottish Power have done most to implement the Guidelines. British Gas has focussed on measures to help vulnerable consumers, Scottish and Southern Energy has focussed on debt prevention and Powergen on debt management. npower has made the least progress.” The review also makes recommendations in a number of areas including on how to assess progress in meeting the Guideline requirements.

The review can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10688_9005.pdf

Assessment of the Electricity Distribution Price Control Review Process

On 22 March, Ofgem published a consultation document announcing a review of the process involved in assessing and setting the new price controls for the distribution network operators to determine what lessons might be learnt to inform the process to be followed in future reviews. Views are invited on the issues raised by **20 May**, there will also be a workshop in May. A conclusions report is promised for July.

The consultation can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10724_9105.pdf

Quality of Service Regulatory Instructions and Guidance version 5

On 24 March, Ofgem issued version 5 of the Quality of Service rigs which are to come into effect on 1 April 2005. The revised rigs can be found at: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10735_9405app.pdf

Electricity Distribution: Academic reports on the long term charging framework

On 24 March, Ofgem published three independent reports from academics on ideas for the future longer term electricity distribution charging regime. This work will feed into the choice of future charging models. The cover note to the papers indicates that Ofgem intends to publish an industry consultation on its thoughts on longer term models in late April 2005.

The cover note can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10737_academic_cover_note.pdf

and the three academics reports at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10739_Turvey.pdf

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10740_Cambridge.pdf

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10741_Strbac_mutale.pdf

Revision of Guidelines on Green Supply Offerings

On 31 March, Ofgem issued a consultation on revising the Guidelines, first issued in April 2002, covering offers of “green” supply to the domestic market. The guidelines are being reviewed in the light of a number of market developments that have occurred since they were first published (including the introduction of REGOs and the requirement for fuel labels), three years experience of the RO, and discussion at a series of workshops organised by suppliers and the Business Council for Sustainable Energy. Views are invited on the issues raised in the consultation and the draft revised guidelines, including extension to non domestic consumers, by **1 July 2005**. The final revised guidelines will be issued later in the year.

The consultation can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10986_10905.pdf

Social Action Plan Annual Review 2005

On 31 March, Ofgem published its review of its work in 2004/5 under its five year Social Action Plan, published in March 2000. A new Social Action Plan will be published in the second quarter of 2005.

The annual review can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10978_10505.pdf

Ofgem Corporate Strategy and Plan 2005 – 2010

Also, on 31 March, Ofgem issued its five year corporate strategy and plan. The accompanying press release places great emphasis on the theme of “better regulation balance” over the next five years. The other key themes: creating and sustaining competition, regulating networks, helping to protect the security of Britain’s energy supplies, helping to protect the environment and helping to tackle fuel poverty follow previous years’ themes.

The plan can be found at

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10979_10605.pdf

and the press release at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10980_r17_31march05.pdf



BETTA

Scotland to plug into new GB electricity market

On 8 March, Mike O'Brien formally announced that, as anticipated, BETTA would go live on 1 April 2005

The press release also refers to a number additional protection measures for Scotland: the Common Tariff Obligation; the replacement for the "Hydro benefit" subsidy; and the assistance for renewable generators in peripheral locations to limit transmission network charges (see below, under DTI, for further details of the CTO and Hydro benefit).

The go live direction can be found at: http://www.dti.gov.uk/energy/domestic_markets/electricity_trading/go_live_direction.pdf

Direction issued by the Gas and Electricity Markets Authority to National Grid Company Plc - Revision of Transmission Network Use of System Charges

On 1 March, Ofgem published its letter giving NGC notice that it could waive the requirement to give not less than 2 months prior written notice of any revised Transmission Network Use of System Charges and consenting to a shortened notice period so that revised charges could come into effect at BETTA go-live.

The letter can be found at: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10402_6305.pdf

Information exchange under the STC The development of Schedule 3 and associated STC and Grid Code changes

On 2 March, Ofgem issued a consultation on the proposed drafting for Schedule 3 to the STC, which limits the information that may be provided to transmission owners by other STC Parties, and consequential changes to Section F. It also deals with an associated change to the Grid Code. Comments were requested by 16 March.

The consultation can be found at: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10409_6705.pdf

On 24 March, Ofgem issued its conclusions, following this consultation, which can be found at: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10734_9305.pdf.

This was followed, on 29 March, by directions to NGC to make amendments to the STC to give effect to its conclusions with effect from 30 March 2005. The direction can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10765_9705.pdf

On 31 March, Ofgem issued derogations to all three transmission licensees in respect of information exchange over the IUDE link, until December 2005. The derogations can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10974_10405.pdf

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10973_10305.pdf

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10972_10205.pdf

Directions pursuant to sub-paragraph 7(a) and paragraph 15 of standard licence condition C18 (Requirement to offer terms for connection or use of the GB transmission system during the transition period) of the transmission licence

On 3 March, Ofgem published directions (dated 25 February) on changes to condition C18 of NGC's transmission licence dealing with the late issuance of connection and use of system offers for some generators. The directions require NGC:

- to issue terms to an existing Scottish User in respect of a site in the North of Scotland that had not expected to connect before BETTA go-live, but where the connection date has been brought forward to before BETTA go-live, by 1 March 2005;
- to issue offers to existing Scottish users who had an agreement as at 1 September 2004, but who will not be connected to or using the GB transmission system at BETTA go-live, by 25 April. There are also consequential amendments to the timescales in which default arrangements are put in place when the user fails to enter into or amend an agreement with NGC.

The letter can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10449_6905.pdf

Amendment to the Connection and Use of System Code ("CUSC") – Decision and direction in relation to CUSC BETTA go-live cut over requirements

On 8 March the authority issued a direction implementing changes to CUSC to deal with the BETTA cut over requirements. The change came into effect on 9 March. The letter can be found at: http://www.nationalgridinfo.co.uk/cusc/pdfs/cusc_cut_over_direction_final.pdf



Embedded Exemptable Large Power Stations (EELPS) connected to Islanded Distribution

On 8 March, Ofgem/DTI published an open letter consulting on its proposal to exempt EELPS that are connected to islanded distribution systems (e.g. in Shetland) from the requirements to accede to the CUSC, and distribution and transmission network owners/operators from their obligations to secure that such EELPS sign up to the CUSC. Comments were requested by **14 March**; the letter can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10608_7705.pdf

On 29 March, Ofgem issued its direction to NGC to modify the CUSC to give effect to its decision with effect from 30 March 2005 (the letter refers to the decision document dated 15 March but it has not been possible to find a copy of this). The direction can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10767_9805.pdf

Consultation on the possible exercise of the BETTA power to implement the BETTA price control licence modifications as a contingency arrangement

On 8 March, Ofgem/DTI published an open letter indicating that if the transmission licensees object to the proposed licence modifications needed to implement the price control arrangements for BETTA, or the statutory consultation raises material issues, then the Secretary of State intends to use her BETTA powers to put in place interim price control conditions to apply from go live. The licence changes would only apply on an interim basis until the finalised proposals can be implemented.

The letter indicates that Ofgem/DTI do not expect that new or material issues will arise that prevent it from implementing the proposed licence changes in the normal way, however it is prudent to plan for this eventuality. The letter invited comments by **23 March**.

The open letter can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsatta/ch/10587_7605.pdf

NGC's proposed GB electricity transmission use of system charging methodology

On 9 March, Ofgem published its decision on its approval of NGC's proposed GB use of system charging methodology giving the detail and background to the decision announced in February.

The Authority's approval is subject to a five conditions. The first three focus on cost reflectivity and the last two on promotion of competition, all five are reproduced below.

Condition 1: "To invite views and to consult on alternative methods of addressing the issue of negative demand charges and to bring forward a proposal to modify the use of system charging methodology in this regard consistent with implementation in April 2006."

Condition 2: "To identify, review and assess further the technical basis for a range of alternative methods (including the method adopted in the approved methodology) of estimating, and reflecting in locational charges, the incremental costs of capacity. NGC should consult with interested parties to identify the range of alternative methods to form part of this technical assessment. If the review identifies potential improvements to the existing methodology, NGC should bring forward modification proposals for implementation no later than April 2007. A report on progress shall be published in April 2006. In the event that NGC concludes that there are no further improvements, NGC should publish a report setting out the conclusions of the review."

Condition 3: "To review, invite views and to consult on alternative methods of treating intermittent generation (such as wind-farms) in the use of system charging methodology. If the review identifies potential improvements to the existing methodology to bring forward proposals to modify the use of system methodology in this regard consistent with implementation in April 2007. In the event that NGC concludes that there are no further improvements, NGC should publish a report setting out the conclusions of the review."

Condition 4: "To invite views and to consult on methods of enabling transmission users to choose to contract for rights to use the transmission system with TNUoS charges fixed at a specified level for periods of more than one year, and to bring forward a proposal to modify the use of system charging methodology in this regard consistent with implementation in April 2007."

Condition 5: "To publish information at least once a year on the forecast future (at least five years) path of tariffs under a range of credible generation and demand scenarios (consistent with those already contained in the Seven Year Statement) as soon as practicable, and no later than April 2006."

Other points of note are summarised below.



The decision document indicates that Ofgem received five complaints under Article 23(6) of the IMED (the European Internal Market in Electricity Directive) and that the Authority considered these complaints as part of its decision making process.

There are no conditions attached to the approval of the BSUoS methodology. However, the paper notes that the Authority considers that some balancing costs might be more accurately charged out on a locational basis but practical considerations rule this out before BETTA is implemented – however NGC should keep the issue under review post BETTA go live.

The Authority has imposed a condition on NGC requiring it to address the issue of negative demand charges in time for April 2006. In the commentary on this issue the Authority notes that it is not persuaded that there is a problem with negative demand charges but recognised the practical issues to be addressed that prevented it being implemented in the relevant timescales. It also comments that there is a range of possible solutions to the issue one of which is a more gradual and well signaled change to the 73:27 split, another is reform to the charging base in negative demand charge zones. However, the paper also notes that it is not currently a requirement of European Law for generators, in aggregate, to contribute a specified proportion of the total costs.

The decision document can be found at: http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10622_8005.pdf

Grid Code – Decision in relation to ‘Grid Code – BETTA Grid Code Go-live cutover’

On 11 March, Ofgem published an open letter to NGC directing changes to the Grid Code, proposed by NGC (plus some minor typo/clarificatory changes) to allow cut-over to BETTA. The changes came into effect on 16 March; the letter can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10649_8205.pdf

BETTA Go-live and contingency planning - Conclusions

On 11 March, Ofgem/DTI published an open letter giving its conclusion that if, after midday on 24 March, it is announced that BETTA go live is delayed then there should be intervention in the England & Wales market to replace the dual imbalance price arrangements with a single imbalance price for a pre defined period.

The period for which the single imbalance price would apply depends on how close to the go live point the deferral is announced with a maximum of 6 days for an announcement after midday on 31 March.

The drafting changes to the BSC that would need to be invoked if this contingency arrangement is triggered have been prepared and are attached to the letter. The letter indicates that these would be implemented at, or near to, the time that any deferral is announced (if one is necessary). No changes are proposed to deal with this contingency in the Scottish market.

Ofgem/DTI is considering how, if it proves necessary, any deferral should be announced including the suggestion that it use the Balancing Mechanism Reporting Arrangements.

The open letter can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10645_8105.pdf

Amendments to the electricity transmission, generation, distribution and supply licences in relation to the legal cut-over to BETTA

On 21 March, Ofgem/DTI published its conclusions the amendments needed to the electricity licences to give effect to the legal cut-over to BETTA on 1 April 2005 – an amended version was published on 22 March. The proposed modifications are included as annexes to the document. Most will come into effect at BETTA go-live, others (related to late issuance of offers) will come into effect before this on the date the Secretary of State signs the directions to modify the licences.

The conclusions can be found at:

http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/10727_8905.pdf

Government Bodies & Other Bodies - DTI

Laying the Common Tariff Obligation (CTO): DTI response to Public Consultation

The DTI has issued its conclusions on the CTO Order; the order that places an obligation on holders of a supply, distribution or transmission licence not to discriminate in their charges in respect of domestic premises solely on the basis of location within the North of Scotland (this area has been re-specified but is unchanged in scope from the original order under the Electricity Act). The CTO will come into effect on 1 April 2005.



The Utilities Act contained provisions to introduce an Order of this nature following the repeal of the previous Order made under the original provisions of the Electricity Act 1989. However, the replacement CTO order was not made at this time (although it is noted that suppliers have operated as if it were in place) and the proposed CTO is being laid before Parliament to rectify the situation.

DTI note that they will review the operation of the CTO in three years time. This review will include consideration as to whether the CTO is an appropriate tool for maintaining common tariffs under current market conditions and extending the scope to include the I&C market.

The decision document, which includes the CTO as an appendix, can be found at:

http://www.dti.gov.uk/energy/publications/policy/cto_response.pdf

Licence exemptable 50-100MW generating stations connected on or before 30 September 2000: DTI response to Public Consultation

The DTI has published its conclusions, following consultation, to extend the current England and Wales definition of licence exemptable generation to Scotland when BETTA is implemented. The decision is to be given effect through an Order amending Class C of the Class Exemptions Order 2001 (and making other minor consequential and typographical changes), to come into effect on 31 March 2005. The decision document, which includes a copy of the amending order, can be found at:

http://www.dti.gov.uk/energy/publications/policy/leg_response.pdf

Assistance for Areas with High Electricity Distribution Costs: DTI response to Public Consultation

The DTI has published its conclusions on the operation of the replacement scheme for the Hydro benefit arrangement which ended in January 2004. The new scheme is given effect through a new order to be laid before Parliament which establishes the scheme and modifies the standard conditions of electricity supply, distribution and transmission licences.

The main elements of the scheme are:

- licensed suppliers are required to pay a p/kWh subsidy to the system operator;
 - payments are to be made quarterly;

- late payments attract interest at 8% above (Barclays Bank) base rate and the additional interest will be used to offset the scheme costs and will not, as originally proposed, be retained by the system operator;
- the total payments are to be reported in the regulatory accounts;
- the total amount to be recovered is £41,950,000 plus the system operator's administration costs adjusted for inflation and any under or over recovery in any year;
- the p/kWh payment by suppliers would be determined from the actual costs to be recovered in any year divided by a forecast of national demand;
- the system operator's administration costs are fixed at £150,000 in year 1 and £80,000 in years 2 & 3, plus RPI (this is a fairly substantial reduction on the original proposal of 1.5% of the amount recovered);
- under and over recovery payments rolled forward are subject to an interest rate adjustment at bank base rate;
- supplier default will be treated as under recovery (with interest applied at the base rate);
- relevant licensed distributors (those in the area specified under the scheme) will apply to the system operator for payments under the scheme which are to be reported separately within their regulatory accounts;
- the payments are to be used to reduce the use of system charges for specified suppliers (licensed suppliers supplying customers within the relevant distributor's area), pro rata with their anticipated demand, in a non discriminatory way; and
- DTI will be responsible for reviewing the scheme in three years time - the review will include assessment of efficiency gains and the impact on the level of the benefit, and the level of the administration charge.

The DTI decision, which includes the order that implements the scheme can be found at: http://www.dti.gov.uk/energy/publications/policy/assistance_response.pdf

**Electricity and Gas
The Electricity (Fuel Mix Disclosure) Regulations 2005**

DTI has published the Fuel Mix Disclosure regulations that require suppliers to provide information on their overall fuel mix in the previous year in accordance with the EC Directive on the common rules for the internal market in (Article 3.6 of Directive 2003/54/EC concerning common rules for the internal market in electricity).



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The regulations, which can be found at: http://www.dti.gov.uk/energy/publications/policy/fuel_mix_stat_inst.pdf, came into force on **18 March 2005**.

Interconnector licences: Determination of standard licence conditions. Conclusions drawn from responses to the November consultation document and standard licence conditions

DTI has published its conclusion on the standard licence conditions for gas and electricity interconnectors in the light of responses to its July & November 2004 consultations. The DTI has made a number of modifications to the draft conditions published in November but states that it does not consider the changes to be material. It has also issued revised and expanded guidance notes and minor changes to the standard terms and conditions. The final version of the standard licence conditions, the revised guidance notes, and the revised standard terms and conditions are attached as Annex A, B & C to the document.

The DTI notes that its discussions with other non GB regulatory authorities and interconnector owners/operators have raised further issues that need to be considered before deciding on the exact treatment of existing interconnectors. However, it proposes that these should be considered on a case by case basis rather than by amending the standard licence conditions that would affect all licensees.

The paper states that DTI will determine the standard conditions by mid March such that Ofgem will be able to issue licences for new interconnectors. Consultation on the proposed licence conditions for existing interconnectors will be issued in mid to late April and the DTI is aiming to issue the prohibition on operation of an interconnector without a licence or exemption by the end of May.

The policy document can be found at: http://www.dti.gov.uk/energy/publications/policy/interconnector_licences_conclusions.pdf

2005- 6 Review of the Renewables Obligation Preliminary Consultation Document

On 22 March, DTI published the first consultation document on its 2005/6 review of the Renewables Obligation. Comments are requested by **13 June**; the accompanying press release indicates that a statutory consultation outlining the Government's final proposals will be published in summer 2005.

The main sections in the consultation are summarised, briefly, below.

- **the effectiveness of the obligation;**

This section provides a brief overview of the development of renewables under the obligation. It refers to the 2002 regulatory impact assessment and the Government's conclusion then that the cost (equivalent to £312/tC saved assuming that renewables displace gas) is justified, and reaffirms this conclusion. There is recognition that a number of barriers to the development of renewables, external to the obligation, need to be addressed to meet the Government's 10% target but notes that Government is confident of "securing strong progress towards the target", and that experience of the RO to date suggests it is having a positive effect on the renewables market.

- **energy from mixed wastes;**

This section focuses on potential changes to ROC eligibility for mixed wastes (e.g. municipal solid wastes or commercial/industrial wastes containing a mixture of biomass and non biomass) and provides a review of Government policy on energy from these wastes. This includes the statement that the Government considers electricity generated from biomass as renewable (independent of any decision on ROC eligibility). The section presents the findings of a consultant's report on issues surrounding amending the RO rules on eligibility of wastes. These findings include:

- electricity generation from waste would increase if included in the RO;
- including waste would have a material impact on ROC values, could lead to the obligation being oversubscribed from 2010, and could displace support for other technologies unless the target levels are also adjusted;
- other mitigating actions would include limiting the proportion of a supplier's obligation that can be met by wastes (although this could reduce the effectiveness of the RO in increasing the amount of waste used to generate electricity).

The consultation puts forward five possible approaches (including no change); views are invited on the options and the issues to be considered when deciding on the approach to be adopted.



- **lower cost renewable technologies**

This section considers whether there is a need to modify the Obligation in some way in recognition that some technologies may become increasingly commercially viable without this support. However, it also sets out some ground rules to ensure that this consideration does not undermine market confidence including confirmation that any changes would not affect existing projects and would only be introduced after a significant notice period for projects commissioning after the notified date.

The consultation reports on findings by consultants that, currently, no eligible technologies are commercially viable and increases in electricity prices due to the EU ETS would have to be much higher than currently anticipated for them to become viable without some support. Because of this the Government states that it will not remove any technology completely but suggests that, based on the consultants' analysis, there may be a case for reducing the level of support for future landfill gas projects and possibly for on shore wind, although the case for change for wind is less clear cut. However, it indicates that there is no case for change for sewage gas and hydropower schemes. The report also raises the question of support for NFFO schemes at the end of their NFFO contracts.

- **Obligation levels beyond 2015/16**

This section considers the pros and cons of increasing the RO target above the new level of 15.4% in the period beyond 2015/16. Government indicates that it has not reached a final view on whether this is necessary at this point in time. However, it gives its current thinking. This includes the view that any such change is unnecessary to incentivise the lower cost technologies but that there may be arguments for making this change to incentivise the longer term technologies. Other arguments against change at this point include the impact on costs to consumers, uncertainties relating to the impact of other potential changes being contemplated in the review, and that decisions now may lead to higher than necessary levels of support.

Views on this issues and alternative approaches to resetting the level of the obligation are sought.

- **Combined Heat and Power**

This section considers the proposal that Good Quality CHP should be exempted from the supply base on which the obligation is calculated.

Any such change, if introduced, would be accompanied by a cap on the total volume of such electricity that can be exempted and a pro rata increase in the level of the obligation such that it does not affect the value of ROCs. The consultation notes that further work is in hand to update an econometric model to assess how much new CHP might come forward if the change is implemented and summarises the findings of a consultant's report commissioned to help the assessment. This report suggests that the change would increase CHP development but not to the level required to meet Government's CHP target, it also raises a number of other concerns.

The consultation also notes that a change of this nature would require changes to primary legislation and could not, therefore, be implemented from 1 April 2006.

- **Operation of the Renewables Obligation certificate market**

This section considers a number of aspects of the operation of the ROC market including the low level of liquidity in the ROC market and its implications and the issues that affect it.

A number of possible changes, suggested by the industry, are discussed:

- changes to the ROC revocation arrangements including fines for ROCs obtained fraudulently (none have been revoked for this reason to date);
- allowing non suppliers to present ROCs (although a number of practical difficulties are identified with this proposal, including the need for primary legislation);
- the introduction of a Market Operator, Administrator or Oversight role (the consultation notes that Government has yet to see clear explanations of what problems and difficulties such an organisation might address); and
- the introduction of an Appeals mechanism against Ofgem's decisions (although the consultation states that Government is not persuaded that the benefits of such a mechanism would outweigh the costs, instead it promotes greater awareness of Ofgem's process for reviewing its decisions on request).



- **Administrative and other detailed technical issues**

This section looks at some of the administrative processes associated with the RO and how they might be improved in the light of experience to date. It covers three areas main areas but notes that the list is not necessarily exhaustive and the DTI is happy to consider other detailed points as the review progresses.

The three broad areas covered are:

- *current timescales and processes*

This includes discussion of a number of possible amendments to tighten the timescales for ROC issue and supplier compliance including simplifying some of the information that needs to be provided.

Changes discussed include:

- issuing ROCs within one month of generation;
- removing the requirement to submit the relevant declarations each month;
- lifting the requirement to notify "input electricity" where it is less than 0.5% of output;
- simplifying fuel measurement requirements for biomass;
- requiring suppliers to notify DTI & Ofgem of their sales by 20 June which would allow the date for compliance to be brought forward from 1 October (and, possibly, reducing the period for recycling the buy-out fund to 6 weeks);
- allowing suppliers to aggregate sales/compliance across all their licences; and
- shorter obligation periods – although this option is not seen as beneficial.

- *Administrative arrangements for smaller generators*

The consultation notes that Government is keen to simplify the administration for smaller generators without removing the appropriate level of rigour. Three possible changes are considered:

- allowing agents to act on behalf of small generators and allowing them to claim ROCs and have ROCs issued to them;

- allowing agents to amalgamate the output from smaller generators; and
- removing the requirement for generators below a certain threshold size to have a sell and buy back agreement to prove the electricity they generate and consume themselves has been supplied to customers in UK.

The consultation indicates that Government's initial view is that the first two would be beneficial in promoting a market in agents providing administration services to smaller generators. All three changes would require changes to primary legislation.

- *Other detailed and technical issues*

This covers a number of miscellaneous aspects of the operation of the RO including:

- allowing a generating unit dedicated to burning biomass, within a station where the other units burn fossil fuel, to be treated as biomass rather than co-fired;
- a proposal to amend the obligation to allow qualifying renewable energy that is stored and then supplied to customers in UK to qualify for ROCs (after adjusting for the efficiency of the storage system and ensuring that non renewable energy used as input energy is excluded from eligibility for ROCs);
- a statement that Government does not propose to amend the obligation to allow landfill gas put directly into the gas network to qualify for ROCs.

The consultation, an initial regulatory impact assessment, and the accompanying consultants' reports can be found at: http://www.dti.gov.uk/renewables/renew_2.2.5.htm

Appeals Arrangements against Ofgem Code Decisions under the Energy Act 2004

The CUSC headline report of the meeting on 18 March records a member's comment that there would be delays in the introduction of appeals arrangements. The CUSC headline report can be found at:

http://www.nationalgrid.com/uk/indinfo/cusc/mn_panel_meeting_dates.html



The Trade & Industry Committee

Responses to the Committee's First Report of Session 2004-05

The Electricity Distribution Networks: Lessons from the storms of October 2002 and future investment in the networks

On 15 March, the TIC published its third "special report" into the lessons learnt from the impact of storms of 2002 for investment in the distribution networks. The special report attaches, as appendices, the Government's and Ofgem's response to the TIC's first report (received on 9 February and 14 February, respectively).

The report special report can be found at: <http://www.publications.parliament.uk/pa/cm200405/cmselect/cmtrdind/433/43302.htm>

Fuel Prices

On 23 March, the TIC issued a press notice announcing the publication of its report into its inquiry into gas price increases and its effects on consumers and on electricity prices and gives some of the TIC's conclusions.

On electricity, the committee concludes that electricity price rises are a direct result of the increase in the cost of the main generating fuels, with differences in prices between companies due to differences in generation portfolios and the adoption of different commercial approaches. It also concludes that the effect of the price increases on customers has been significant and, over the medium to long-term, electricity is unlikely to be as cheap in real terms as it has been over the last six years. The committee calls for Government to re-examine the operation of the Climate Change Levy and the scope for reducing it.

The report will be published after Easter.

The press notice can be found at: http://www.parliament.uk/parliamentary_committees/trade_and_industry/tisc_pn32_0405.cfm

EU Emissions Trading Scheme

UK announces next steps on EU Emissions Trading Scheme

On 11 March, DEFRA and DTI announced that it intends to issue allowances to UK operators covered by the EU ETS "as soon as possible".

This allocation will be made on the basis of the original UK total set out in the UK's draft National Allocation Plan (NAP) submitted to the EU in April 2004 (i.e. a total of 736 million allowances).

It is understood that the shortfall between this total and the total set out in the revised NAP, submitted in November 2004 and proposing 756 million allowances for UK, will be recovered from the allocation to the generation sector. At the same time, government announced that it will be initiating legal proceeding against the EU which has indicated that the previous figure of 736 million allowances cannot be exceeded. It is also understood that, if the government is successful in its challenge, the additional allowances will be allocated to the generation sector.

The press release can be found at: <http://www.defra.gov.uk/news/2005/050311b.htm>

The UK Government approach to EU ETS Phase II

On 31 March, Government published an information paper on its approach to Phase 2 of the EU ETS covering:

- "Government aims and objectives for developing a Phase II NAP;
- Current activities and timetable to submission of Phase II NAP to the European Commission;
- Details on how stakeholders can comment on and participate in the decision making process for the Phase II NAP;
- Priority issues on which we will be focusing in the coming months, namely:
 - Setting the total quantity of allowances for Phase II;
 - Allocation methodology including wider use of benchmarks, auctioning and treatment of new entrants; and
 - Seeking greater harmonisation of allocation approaches with other Member States."

The main differences between Phase 1 and Phase 2 which may be introduced from 2008 are:

- penalty payments for non compliance increase from €40 to €100 per tonne;
- Member States can include other green house gasses within the scheme;
- Members States may use credits from JI (Joint Implementation) as well as CDM (the Clean Development Mechanism) subject to limits;
- there will be no temporary exclusions; and exchange of allowances between Members States will be backed by an equivalent exchange of Kyoto AAUs (assigned amount units).



The NAP for Phase 2 needs to be submitted to the Commission in **June 2006** and installation specific allocations must be made by **December 2006**. DEFRA is expecting to consult on the Phase II NAP in summer 2005 and indicates that a draft NAP for Phase II should be available “around the turn of the year”.

Although the document is not a formal consultation, views on a number of specific issues are invited by **31 May 2005**.

The report can be found at:

<http://www.defra.gov.uk/environment/climatechange/trading/eu/pdf/phase2-govapproach.pdf>

The report is accompanied by summary information on a number of consultancy contracts that have been let to support this area of work, this can be found at: <http://www.defra.gov.uk/environment/climatechange/trading/eu/pdf/phase2-consultcontracts.pdf>

The BSC and CUSC

BSC New Modifications

Authority Decisions

On 31 March 2005 the Authority APPROVED **P180** (Revision to BSC Modification implementation dates, where an Authority determination is referred to Appeal or Judicial Review) with an implementation date of 07 April 2005.

Modification to the Balancing and Settlement Code (“BSC”): Direction in relation to an inconsistency with the Grid Code - The Authority directed NGC to modify the BSC to redefine “National Demand” as “GB National Demand”, effective from go live, to bring it in line with the equivalent change to the GB Grid Code.

BETTA Effective Date - On 11 March, the Authority confirmed that the “BETTA effective date” is 1 April 2005, in line with the Secretary of State’s decision that BETTA will go live on 1 April. The letter can be found at: http://www.elexon.co.uk/documents/Betta/Betta_-_Related_Documents/BSC_notice_of_the_BETTA_effective_date_.pdf

BSC Parties – joiners and leavers

On 1 March, **Powerrelate Ltd acceded to the BSC**.

British Energy Retail Markets and Wainstones Power Limited withdrew from the BSC on 28 February 2005 and, on 10 March, the **European Power Source Company** withdrew.

BSC Miscellaneous

ELEXON Business Strategy and Annual Budget 2005/08

On 1 March, ELEXON issued a press release announcing the publication of its three year business and annual strategy. The press release headlines the £20million reduction in the annual budget attributing some of this to the completion of repayment of the NETA costs and the re-procurement of two major contracts under which resulted in an annual saving of £6.5m

The press release can be found at:

http://www.elexon.co.uk/documents/Newsroom/Press_Releases_2005/ELEXON_Business_Strategy_2005-2008.pdf

Public Peer Comparison

On 21 March, ELEXON issued a circular indicating that the Performance Assurance Board will be publishing peer comparisons on suppliers’ performance against two Serials (performance standards). The Serials are:

- SP08a – Percentage of Non Half Hourly Energy settled on Annualised Advances at Final Reconciliation (RF); and
- SP09 – Percentage of Non Half Hourly Metering Systems settled on default Estimated Annual Consumptions at Third Reconciliation (R3).

The first reporting period will be April 2005 and the peer comparisons will be published no earlier than 14 June 2005.

The circular can be found:

http://www.elexon.co.uk/documents/circulars/Elexon_Circular/EL01279.pdf

CUSC Amendment Proposals

CAPs 079 – 084: NGC has raised 6 CAPs in March covering “Housekeeping Amendments”.



**IPA ENERGY CONSULTING MONTHLY BRIEFING
THE PACE OF CHANGE IN GREAT BRITAIN**

CUSC Authority Decisions

On 31 March, the Authority APPROVED **CAP 077** (Revision to CUSC Amendment Implementation dates where an Authority decision is referred to Appeal of Judicial Review) – to come into effect ten business days after the decision date.

Amendment to the Connection and Use of System Code (CUSC) – Direction in relation to Ofgem’s conclusions on the treatment of embedded exemptable large power stations (EELPS) under BETTA - Ofgem has directed changes to the CUSC to give effect to its decisions (reported last month, under BETTA) on the treatment of EELPS.

DISCLAIMER

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