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19th January 2005

Dear Richard,

GB Transmission Charging: Use of System Charging Methodology
Revised Proposals Consultation

Thank you for the opportunity to respond to these revised proposals – this response is submitted on behalf of First Hydro Company (now owned by IPM Eagle LLP, a joint venture between International Power plc and Mitsui & Co., Ltd.)

Our comments relate to the revised proposals for the TNUoS Charging Methodology, following Ofgem's rejection of both of the original Scenarios A and B, as submitted to them on the 30th September 2004.

Given the pressing timescales, we have in this response concentrated on the areas where we feel NGC need to make further changes to their proposals for 2005/6, together with some suggestions for further reviewing/improving the methodology over the next 12 months.

In summary:

- We disagree with NGC's proposal to revert to the current G:D allocation of transmission charges
 - This ignores the benefits of moving towards a G=0 target to support EU policy objectives
 - It materially conflicts with market expectations of charges due from April 2005
 - We propose allocation of charges for 2005/6 on an 80:20 basis between Demand and Generation
- We agree with NGC's proposal to define a medium term 'staircase' approach, and suggest targeting G=0 over the next 2 years
- We would like NGC to review embedded generation issues and information transparency ahead of the 2006/7 charging methodology

Summary of First Hydro's views to date

First Hydro supported NGC's preferred option B that was submitted to the Authority on the 30th September 2004. We viewed the main benefits of the proposal as:-

- improved cost-reflectivity through the use of multi-voltage expansion constants
- more stability in tariffs than those resulting from Scenario A
- prevention of the occurrence of negative demand charges by implementing a change to the G:D split
- support of EU policy objectives on tariff harmonization by moving towards a G=0 scenario
- some improvements to the calculation of cable factors which improve cost-reflectivity (these had previously been overstated).

Issues raised by the December 04 consultation

Governance Process

Procedurally, the establishment of the initial GB charging methodologies has involved a series of NGC consultations, as well as an Ofgem Impact Assessment. Whilst Ofgem have a valuable role in providing a broader perspective to major market change proposals, it is clear that the process to date has been ineffective in providing industry players with clear cost signals against which to manage and plan their businesses. It is extremely disappointing that the issues raised by Ofgem in its December conclusions, could not have been raised earlier in the process at one of the many seminars or through one of the consultations. Equally it is disappointing that NGC's revised proposals are now materially different to the original final proposals, involving a significant reallocation of costs back onto generators, very late in the day.

Overall, the governance issues around transmission charging are clearly unsatisfactory – the arrangements should be reviewed to create a more stable framework that allows more direct involvement from those paying the charges.

G:D split

The key difference between the September and December 04 proposals is the G:D split. Under the original Scenario B, this allocation was modified from the current 27/73 to 10/90 for two reasons: first as an initial step in the move towards a G=0 solution, and secondly to remove the possibility of negative demand charges. This appeared to receive fairly broad support through the NGC consultation process.

Following Ofgem's Impact Assessment and comments received, Ofgem have rejected scenario B, citing the change in the G:D ratio as being disproportionate in dealing with the issues relating to negative demand tariffs. Concern was also raised that the large step change in demand charges would simply represent increased costs to the consumer in the short term. Scenario A was also rejected, but on the grounds that it was not sufficiently cost-reflective.

Having reviewed the issue using NGC's charging model, the negative demand charge results in a contribution of around £700k from other demand to fund the payment. The original solution to change the G:D split to 90/10 involves moving around £187m of charges from generation to demand. Therefore, if the sole reason for altering the G:D split were to resolve the negative demand tariff issues, it would not be a 'proportionate' response.

However, this is to ignore developing policy on EU tariff harmonization, which has been highlighted throughout the lengthy consultation process as supporting the G:D

changes. As a response to Ofgem's rejection of B, NGC have simply reinstated the current G:D split. This we believe is a 'knee jerk' reaction to regulatory criticism of the original proposals which adds to the cost uncertainty faced by generators and suppliers - there is no suggestion in Ofgem's conclusions document that consistency with EU objectives should be ignored, or that a smaller step change towards G=0 would not be appropriate.

After all, since last Summer, there has been a market expectation that there would be a change (80:20 in NGC's initial proposals.) Had the UoS proposal been approved by Ofgem in December then we believe that there would have been sufficient time to allow the market to re-adjust to the new cost drivers which would have protected customers from additional cost associated with the change. To reverse this position at this late stage patently does not improve the delivery of cost signals to the market.

Whilst, therefore, First Hydro supports NGC's proposals to plan the medium/long term shift to G=0 such that it can be signaled in advance to the market (and help to avoid any significant, short term, adverse impact on consumers), we would expect that some progress can be made from 2005/6.

For instance an 80:20 allocation from April 2005, could be developed over the following two years to reach G=0 by April 2007.

275 and 132 kV line factors

We support the use of a better representation of circuit upgrade potential such that circuits that can be upgraded to a higher voltage should be represented by the higher voltage expansion constant. The practical reality is that this is best implemented by the use of TO specific expansion constants.

Important areas that are not covered in NGC's revised proposals

We believe that there are two areas that should be addressed over the next charging year.

Embedded Generation

Embedded generation is treated by the various TOs as negative demand - for the purpose of the transport model the forecast of generation effectively offsets the relevant GSP demand.

The GB model has led to the creation of a number of 'negative demand' nodes where the level of embedded generation actually exceeds the nodal demand. In fact these nodes account for over 700MW of 'negative demand' in GB. Given that this represents significant amounts of power being exported onto the transmission network, often without involving TNUoS charges, it raises the question of whether the current treatment of embedded generation is still appropriate.

For instance, there are different treatments of negative demand and generation in the transport model:

- generation is scaled to winter peak conditions, whereas 'negative demand' is not
- the generation proportion of the G:D split is not charged to all parties that contribute to nodal 'negative demand'

We believe that NGC should undertake a review of the treatment of embedded generation to ensure that the effect of treating it as negative demand in the transport model does not create any perverse incentives.

Calculation of the value of the expansion constant

Whilst significant information is available on the current capability of the GB network in terms of its technical capability we feel that there is not yet sufficient information available as to the derivation of the value of the expansion constant (£9.78/MWkm) and the various line and cable factors.

The reason that has been given in the past is that these costs are based on NGC's recent tenders received and that publication could breach commercial confidentiality arrangements with suppliers. We believe that NGC should publish the basis of their derivation of the expansion constants (presented so as to protect individual projects if necessary.) This would allow users to have a greater insight into the costs of developing the transmission system.

I hope that this response is self explanatory but please do not hesitate to contact me if you require any clarification.

Yours sincerely,

Kevin Dibble
Director, Marketing