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6<sup>th</sup> February 2004

Dear Stuart

### **GB Transmission Charging: Initial Thoughts**

Thank you for the opportunity to comment on your recent consultation document. We also note the addendum issued on the 27<sup>th</sup> January 2004, containing various tariff scenarios, "to illustrate sensitivities that have been raised by Users." Our own initial thoughts are set out below.

One of the cornerstones of the proposals is that the approved 2004/5 England and Wales charging methodology is adopted GB wide. As we have previously commented (in responses to the 2003 Transmission Charging Review), we are concerned that the use of the ICRP load flow model, particularly in its latest form, does not better meet the relevant objectives contained in NGC's licence. Our concerns are reinforced by the recent finalisation of TNUoS tariffs for 2004/5, which shows significant movements from the indicative tariffs, and even some zonal boundary changes. We believe that this demonstrates a lack of robustness in the new model, which is not consistent with the provision of stable long term investment signals to users.

#### *NGC licence objectives*

There are a number of competing licence requirements on NGC that any modification to the charging methodologies needs to meet. These are, primarily:

#### C7A

- 5a facilitate competition in the generation and supply of electricity
- 5b reflect costs incurred in the licensee's business
- 5c take account of developments in the licensee's transmission business

There are clearly trade-offs to be made when constructing charging methodologies in attempting to address all of these criteria. The current methodology starts with a load flow model producing nodal prices that give the additional MWkm that would be occur if the generation at the node was increased by one MW. This is then multiplied by a security factor and expansion constant to arrive at the nodal price. Nodes are then grouped to arrive at zonal tariffs.

We believe that some of the changes made via the review process have not achieved an improvement in 5b, and have also been made at the expense of objective 5a.

#### *Issues raised through the consultation document*

The 'initial thoughts' on GB charging are based on the assumption that the ICRP methodology described above better meets NGC's licence objectives, resulting in consistent and stable long term investment signals for users.

However, Edison Mission Energy continues to believe that the ICRP methodology is fundamentally flawed, particularly when applied to a well developed system that is relatively unconstrained. The inclusion of a locational security factor goes further towards distorting competition by imposing an additional burden on northern generating plant. Furthermore, we are still not persuaded that a locational security factor actually improves cost-reflectivity – security has been handled via a flat charge for many years without any apparent need for change.

We have made further observations (some based on the recent finalisation of tariffs for 2004/5) which highlight potential shortcomings in the modelling in terms of creating consistent and stable investment signals to existing and new players. These should also be included within the scope of the GB charging review. They include the following:

- The zonal TNUoS generation tariffs are designed to indicate the marginal system cost of introducing new generating capacity. Existing plant is being charged not based on the cost it imposes on the system but the hypothetical cost new generation might impose on the system in that zone - the charges are therefore not cost-reflective for existing plant. (The debate over whether marginal pricing is more cost-reflective than 'average' pricing is one which has dominated discussions on cashout pricing under the BSC. Despite there being outstanding modification proposals to introduce marginal pricing, in all previous determinations relating to this issue, OFGEM has been clear that marginal pricing is less cost-reflective than average pricing)
- If NGC invests in infrastructure (re-stringing lines, new circuits) the costs in the area where the reinforcement occurs goes down but the cost goes up in areas that are not reinforced. The implication of this is that again the party who causes the cost is not subject to it.
- The model appears to be sensitive to changes in TEC and Users Demand forecasts, which can lead to significant swings in zonal tariffs. We believe that the procedure regarding starting assumptions should be reviewed – otherwise the modelling will be vulnerable to (portfolio) players influencing the geographic distribution of costs.

### *Scenarios contained within the addendum*

We are extremely wary of passing any comment on the numbers presented in the addendum – not only do they represent an extremely wide range of potential outcomes, but the 2003 review process has highlighted that the numbers require more detailed definition before meaningful comment can be made. The finalised tariffs for 2004/5 differ sharply from the indicative tariffs that formed the basis for NGC's consultation proposals – we note the material impact of these final tariffs on some industry players.

We do however offer the following brief comments on some of the assumptions used:

- With respect to scenarios 3 and 4 - changes to individual expansion constants were not considered under the E&W review and we see no justification for these scenarios being included. The suggestion that 132kV expansion constants should be based on the 275kV costs (on the basis that incremental capacity would be built at the higher voltage) is highly presumptuous and potentially discriminatory. If this concept is to be introduced then all expansion constants should be reviewed in the same way.
- If NGC wish to pursue scenario 5 then for consistency all circuits (cables and lines) should be treated with the same expansion constant. We had suggested this as part of the previous review – we believe it is more cost-reflective as incremental capacity may well be built at a different voltage or the decision to reinforce an existing cable may well be achieved via overhead line. A weighted average of the current mix of circuits on the GB system would be most appropriate.
- We think that an additional scenario with the security factor set to 1 should be produced – see reasons set out above.

In all cases, it is important that the Scottish area is treated consistently with England & Wales – we agree with the initial GBSO for instance that the zoning criteria should be applied consistently across GB

### *Transparency*

We note from the latest Operational Forum that NGC is to conduct a review of transparency issues this year. We believe that its modelling of transmission tariffs should form part of this review – this would aid the understanding of all users and better inform any consultation process. In particular it may be useful to establish some form of expert user group to allow greater industry involvement in and scrutiny of this critical area.

### *Potential for Wider Review*

Our arguments above support the need for a more fundamental review of transmission charging. We fail to see how the latest arrangements should become the basis for GB

charging – they do not in our view better meet NGC’s charging objectives, but there are other solutions available which can.

We believe that there is a case for this review to be undertaken independently by Ofgem/DTI with the aim of determining the best methodology going forward for the GB market. Already we have seen several proposals to subsidise in some way plant in Scotland that is remote/renewable/small. This review would have the added potential to handle these issues in a more consistent fashion, allowing DTI/Ofgem to resolve charging issues with their wider environmental and policy objectives.

We hope that these comments have been useful in helping NC to scope out its forthcoming review of the GB charging methodology - should you require any further clarification on this response please contact myself or Simon Lord.

Yours sincerely

Kevin Dibble  
**Director, Marketing**