

21st January, 2005

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Dear Richard,

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

Thank you for the opportunity to comment on the above consultation.

Our views on the proposal presented by National Grid and on the issues raised by Ofgem within the consultation are below. However, we would also like to take this opportunity to raise some concerns about the current process being adopted by Ofgem in approving the GB Charging Methodologies.

The principle of developing a GB Transmission Charging methodology based on the existing methodology for England and Wales, was decided over three years ago. Since then, via the Transmission Charging Methodologies Forum (TCMF), National Grid has openly engaged in a dialogue with all affected parties. The rejection of both of NGC's proposals by the Authority has given rise to significant and unnecessary uncertainty and business risk to the industry (especially suppliers) and large consumers.

With the Authority's announcement in December 2004 that it had decided not to approve NGC's recommended approach to transmission use of system charging, it now appears that final tariffs will not be approved until the end of February 2005. As a supplier we are now in an impossible position with regards to risk management. In order to offer prices to customers we have to take on an unknown risk through making our own assumptions on what the tariff will be or transfer the same risk to our customers through offering "energy only" contracts. Furthermore, as a generator, we face uncertain costs that are likely to be significant which is damaging for our business and for market confidence in general.

Even if there is little you can do now to accelerate the path towards final approval, I would urge you to do all you can not to introduce any further delays this time round, and to ensure that the process is improved for future years.

British Energy continues to support Scenario B as originally proposed. We do not support NGC's revised charging proposals as set out in this consultation. We are very supportive of NGC's proposals for phasing in a move to $G = 0$.

Key Points

- **As a point of principle British Energy (BE) supports a move towards removing generator charges (G=0) in order to align with other EU Member States' position.**
- **Charges should be stable, predictable and proportionate as far as is practicable. There should be no special treatment within the charging methodologies for any particular group as that would distort competition.**
- **BE does not support transmission charges that vary excessively by location. Whilst we recognise that the DCLF model may approximately reflect actual power flows in the system, the case for marginal cost locational pricing in a system with large sunk costs in operating assets is weak.**
- **The application of the GB Model as proposed still contains uncertainties. We therefore do not have confidence that it provides users with a reasonable estimate of illustrative charges under BETTA. The continuing uncertainty over the final tariffs creates additional business risk, for both generators and suppliers.**
- **BE does not support the idea of a Locational Security Factor. System security is of benefit to all – particularly in a highly interconnected system like ours - and costs associated with its provision should fall equally on all users. BE does not support the extension of the Locational Security Factor on a GB basis.**

GB Balancing Services Use of System (BSUoS) Charging Methodology

We agree that it is reasonable to leave the BSUoS Methodology as it was in the previous consultation.

We also agree that it is practical and pragmatic to tie the liability for BSUoS in the specific cases stated to the power station rather than the BSC party.

GB Use of System Charging Methodology

Negative demand charges

It is undoubtedly the case that negative demand charges would introduce perverse incentives for example by encouraging inefficiency. Consequently, any proposal that introduces negative demand charges would run counter to the general duties of the Secretary of State and the Authority. We do not therefore support negative charges.

However, the means employed by NGC to avoid or remove them in the short term departs from the principles underpinning the locational charging framework and is therefore invalid and discriminatory.

Instead, we strongly support National Grid's suggested move towards $G = 0$ as the more permanent long-term solution to the problem of negative demand charges. In any event, such a move is more economically efficient than leaving the G/D split as it is and is also in accord with the way transmission charges are levied in many other EU Member States. .

Unit Cost of Incremental Capacity

As a fundamental principle BE does not support the use of forward-looking investment modelling to recover sunk transmission network costs. Whilst we recognise that the DCLF model may approximately reflect actual power flows in the system, the case for marginal cost locational pricing in a system like ours with large sunk costs in operating assets is weak.

The difficulty demonstrated in National Grid's analysis is that the upgrade or reinforcement of a particular part of the system has an impact which goes wider than the ends of the specific lines directly involved. Similarly, , excess capacity in other areas of the network can have an impact on specific lines elsewhere on the system. A highly interconnected system, as we have in GB, will always have this characteristic.

Thus any model of such a system will always experience some mismatch in the cost of specific lines versus the charges levied on specific generators. To have them more closely aligned would logically move us back to deep connection charging.

We consider that the unit cost of incremental capacity used by National Grid does not understate the position.

Multi-voltage Expansion Factors

BE does not support transmission charges that vary excessively by location for incumbents. A change in the distribution of charges according to location would unfairly penalise some incumbents, while bringing windfall benefits to others. Whilst there are some arguments in favour of using TNUoS charges to provide locational signals for new investment, other factors, such as availability of fuel sources, planning considerations and site availability, are likely to dominate decision-making.

National Grid's approach in this consultation where a fixed overall percentage of circuits are modelled at an alternative voltage is preferable to one where specific individual circuits are modelled. This is because a non-locational approach should provide greater stability of charges within this version of the methodology by mitigating against any difficulty arising in future from large changes in particular zones.

We do however have an issue with the fact that there are now separate expansion

factors for three arbitrary (from the point of view of the model) areas in the GB system. There would need to be a robust mathematical justification (similar to zoning criteria) to justify this method. This would presumably lead to factor regions in England and Wales also.

To refine only one aspect of the model in this relatively arbitrary way is a disproportionate approach as it overemphasises the impact of the multi-voltage expansion factors when compared to the other model parameters. It also moves away from one of the fundamental principles of the move to GB charging which should be to have a single set of consistent criteria across GB.

Spare Capacity

Having examined the arguments proposed by National Grid we remain unconvinced that the modelling of spare capacity is correctly represented, specifically:

- National Grid's argument that the differential nodal costs are being solely on the actual power flows
- Consistent locational signals are being given
- A more robust methodology for accounting for spare capacity if it is to be included in the model.

GB Security Factor

BE has stated previously that it does not support the idea of a Locational Security Factor. System security is of benefit to all – particularly in a highly interconnected system like ours - and costs associated with its provision should fall equally on all users. BE does not support the extension of the Locational Security Factor on a GB basis.

The use of a “Locational Security Factor” exacerbates negative charges which, in BE’s view, are a result of a flawed methodology which recovers the predominantly sunk costs of the transmission network on the basis of marginal cost modelling.

Other Issues

Uncertainty over future GB tariffs represents an unhedgeable risk to supply businesses in future years. National Grid should be obliged to publish firm tariff information at least six months ahead of implementation otherwise supply competition will be damaged.

As we have stated earlier there are good arguments in favour of a further move in the G/D split towards $G=0$, as this would be in line with practice in most other European States.

If you have any questions regarding this response please do not hesitate to contact me.


Yours sincerely,




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