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Dear Stuart,

GB Transmission Charging: Initial Methodologies Consultation

Powergen agrees with the general continued move to extend the charging arrangements presently used in England & Wales across Great Britain as a whole. However, we have serious concerns about the proposal to dilute locational signals which would totally undermine the creation of a competitive market in GB and would create another cross subsidy to incumbent companies in Scotland.

The basis for charging

We agree that all users connected to the transmission system should be subject to transmission charges. We note the concerns by some parties that this would mean different rules for generators connected at 132kV in Scotland compared with those in England & Wales. However, we reiterate our view that the voltage of connection is not important when deciding whether charges should be paid. The determining factor is what the assets concerned are used for. If it is transmission then those parties are using the system and should pay transmission charges.

Locational charging and introduction of cross subsidies

The purpose of BETTA is to provide a competitive market for the whole of GB, which involves providing a level playing field for all participants. In the context of transmission charging, this does not mean that all participants should face exactly the same level of charges, but it does mean that participants should be faced with charges which reflect the costs they cause to be

incurred on the system. To do otherwise results in cross subsidies between participants which distort competition. Under a shallow charging system for transmission access (which will exist under BETTA) fully cost reflective charging is not possible, as by definition participants are not exposed to the full costs of investment made to the system as a result of their connection. However, the locational charging methodology proposed under Scenario B, using DC Load Flow modelling goes some way to provide a cost reflective charge for use of the system. It must be remembered, however, that due to shallow charging this is already a watered down signal and is therefore not fully cost reflective.

Under pressure from some participants operating in Scotland, especially those representing renewable generation interests, the DTI and Ofgem appear to have decided that subsidies should be introduced into the transmission charging arrangements in respect of renewable generation in northern Scotland and for small transmission connected generators in Scotland as a whole. This will create a distortion in the market which will discriminate against conventional larger plant in Scotland and all plant in England & Wales, renewable or otherwise. It is therefore, crucial that NGC does not seek to introduce a further subsidy into the arrangements. As one of the country's biggest investors in renewable generation, we are concerned about the effect these distortions in the trading arrangements will have on projects elsewhere in the country. We would be concerned if proposals to build large scale renewables projects in the south east of England were jeopardised as a result of providing transmission subsidies to small scale projects in the north of Scotland.

Scenario B in the consultation document provides a different expansion constant for each voltage of infrastructure. Given that the costs appear to differ significantly by voltage level, then it is appropriate to maintain this measure. We note that the constant derived for 132kV assets under this Scenario also takes into account NGC's estimate that around 20 percent of these assets will be upgraded to 400kV, which should bring further accuracy to the calculation. In contrast, Scenario A uses the 400kV expansion constant for all voltages. This is clearly not cost reflective, but has apparently been brought in to make the tariffs more stable.

This raises three issues. Firstly, no evidence has been provided to suggest that tariffs under Scenario B will be unduly volatile. Moreover, on page 18 of the consultation document NGC states that the present E&W methodology has not suffered from instability and that it considers concerns to this effect to be "overstated". Secondly, it has not been explained why volatility is a bad thing. We feel that volatility has been confused with predictability. There is no suggestion in the document that Scenario B would result in tariffs which are less predictable than Scenario A. We would argue that tariffs should be predictable, but that they should be allowed to react to changes in generation and demand on the network. Otherwise, for instance, generators remaining in a zone would not be able to benefit from lower tariffs resulting from other plant

closing or mothballing. Finally, NGC has stated that it believes that Scenario A would be better for competition as a result of being more stable. We do not believe this simple assertion that stable prices equate to a more competitive market. In fact it is more normal for competitive markets to produce prices which react quickly to changes in supply and demand.

We therefore do not accept the argument that this less cost reflective charge would further benefit competition. If the proposal in Scenario A were to be implemented, then a further distortion of locational signals would be created over and above that which will be introduced by the above subsidies. This would again disadvantage generation in England & Wales and further call into question whether BETTA was creating a free and fair market for all.

Recovery of revenue paid out under the Hydro Benefit, Renewables Discount and Small Generator Discount Subsidies

We oppose the implicit subsidies suggested by the DTI and Ofgem to provide discounts from transmission charges as described above and to continue the subsidy to the Scottish Hydro's distribution business. However, we understand that should they be implemented then NGC's role is purely to recover the money on a fair basis. We do not see a particular issue with NGC's proposal to recover the money associated with these subsidies on a commodity charge basis.

I hope the above proves helpful. Please contact me on the above number should you wish to discuss this further.

Yours sincerely,

Paul Jones
Trading Arrangements