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20th January 2005

Dear Richard,

**GB transmission charging: Use of System charging methodology revised
proposals consultation, December 2004**

Thank you for the opportunity to respond to the consultation on National Grid (NGC)'s revised final proposals for the transmission use of system (TNUoS) charging methodology to be applied across Great Britain (GB) from 1 April 2005.

As you may recall from our previous responses on NGC's original final proposals, Immingham CHP has consistently supported development of the GB charging methodologies from 1 April 2005 based upon the 'Plugs' and DCLF concepts adopted in the amended England and Wales (EW) charging arrangements. We endorsed the conclusions reached by NGC in formulating its final proposals, especially its support for option B. We continue to believe that adopting more cost reflective charges, subject to a cost/benefit analysis, remains the most appropriate way for NGC to meet its licence obligations.

Against this background, ConocoPhillips believes the Authority has moved away from the principle of cost reflectivity in its request to NGC to reassess the final proposals, and this can only undermine the economic efficiency of NGC's transmission charging structures. Specifically, we see no merit in reverting to the old cost split of 73:27, especially given the problems this creates in having to neutralise negative demand charging, which can create perverse incentives to increase demand at system peak times. We suspect such an approach is inconsistent within the government's wider low carbon policies.

If, for whatever reason, Ofgem endorses NGC's revised proposal it should be explicitly on the basis that this is a transitional step. We agree with NGC's observations that the revised approach to negative demand charges it has brought forward should be a temporary measure. In particular we support the proposal that a longer-term approach should be adopted. The example given by NGC – that 5% steps could be adopted each year (7% in the first year 2006/07), arriving at the 10:90 split in 2008/09 – would seem to provide an appropriate outcome.

We would like to highlight Ofgem's approval of phasing associated with the recent price control review for distributors', a precedent that has only recently been endorsed. On this basis, Immingham CHP believe it is appropriate for National Grid to submit an alternative Option C to Ofgem which incorporates the phasing element as a conditional approval of the TNUoS methodology. The phasing element provides a commitment in the long-term transparency of TNUoS charging, constantly requested by the generation community. It also achieves all of Ofgem's objectives without sacrificing cost reflectivity and short-term consumer interests.

We have the following detailed comments about the revised principles underlying Option B charges and on NGC's further analysis:

- We note that the Authority continues to recognise that Option B is the more cost-reflective option compared to Option A, and that cost reflectivity is of primary importance to facilitate competition in generation and supply. It is, in the form originally proposed, also more consistent with the direction in which European Commission policy objectives for network charging are heading. We would anticipate that over time the split of charges will move further towards the position where TNUoS charges are not recovered from generation at all. We believe that the Authority's request for a revised Option B, using the original 27:73 split of charges between generation and demand users, is an unnecessary step back from the progressive approach highlighted in the original Option B, and will merely delay matters in order to temporarily placate demand users.
- We are concerned that the Authority has not fully taken on board NGC's concerns regarding negative demand charging, which it was seeking to address through original Option B, and the perverse incentives to increase demand at system peak which could, in certain circumstances of system stress, impact on system security.
- In the absence of enduring proposals from NGC, we would reiterate our view that negative demand charging is a problem whose removal requires a long-term solution. NGC's attempt in the revised proposals to set a de minimis level of £0/kW is a first step, but we believe that a commitment should be given now for NGC to review the matter further as part of an overall review of long-term GB charging after BETTA implementation.
- The timing of BETTA implementation has been known for a considerable time but the protracted nature of the process for determining GB transmission charges has caused significant unnecessary uncertainty in the market. We remain concerned that the revised final charges set out by NGC remain indicative and

are, according to the latest timetable, still not due to be finalised until the end of February 2005. This state of affairs places NGC in breach of its licence and is unacceptable. Grid users need transparency and certainty in the monopoly charges they face, and NGC should be required to provide its final charges to the market as soon as possible, once the Authority has determined its position on the revised proposals.

- In this context, we note that NGC has provided a further revised overall level of recoverable allowed revenue upon which the TNUoS charges are calculated. However, NGC has also noted that further adjustments are likely to reflect the final TO price control proposals. We would urge NGC to seek early clarification of the level of recoverable allowed revenue so that the TNUoS charges can be set as a matter of urgency.
- We remain concerned that variability in charges will still arise year-on-year because of the application by NGC of the proposed methodology. NGC's previous analysis has highlighted the potential for instability with Option B charges over 2006/07 and 2007/08. There is no indication that this position will change with the revised proposals. We have previously noted that it is essential for NGC to seek to dampen the instability of cost reflective charges year-on-year by developing an option for sensible long-term charging. Such a mechanism will enable grid users to hedge unnecessary risk outside of their control. We believe that NGC should honour, as soon as possible after BETTA implementation, its undertaking to carry out a meaningful review of long-term charging options.
- We note that, as part of the Authority decision on the original charging proposals, there remains an intention to progress with the discount to small 132kV transmission-connected generation in Scotland, and NGC has duly provided an indication of the level of discount on offer. We retain the view that this discount, and any other subsidies, should be a separate issue, to be developed by the government, and should not be incorporated into the GB charging methodology.

Please contact me on 020 7408 6233 if you have any questions regarding this submission.

Yours sincerely,



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