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17 September, 2004

Dear Richard,

GB Transmission Charging: Final Methodologies Consultation

I am responding to the above paper on behalf of E.ON UK. We continue to believe that Scenario B should be implemented and we welcome NGT's conclusion that this better meets its objectives. It is vital that the GB transmission charging methodology supports competition, along with effective investment in generation capacity and infrastructure, by providing the most cost reflective solution possible within a shallow charging regime.

Many of our comments in support of Scenario B have been made in previous submissions and we therefore do not intend to repeat them again. This response focuses on issues which have arisen since the last consultation paper in April.

Scenarios A & B, cost reflectivity and stability

Scenario B is clearly the more cost reflective of the two options developed by NGT and we therefore believe that this should be the option that is submitted to the Authority for consideration. The implementation of Scenario A would create cross subsidies between participants which would give some parties an unfair advantage over others, thereby eroding competition in the market. It would also be likely to lead to inefficient decisions in the location of new, and the closure of existing, generating plant with subsequent impacts on transmission investment decisions. This would have environmental as well as economic cost implications.

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Scenario A was originally advocated on the basis that, although it was less cost reflective, it would provide more stability than Scenario B and would therefore better promote competition. We continue to disagree with the assertion that stability is more important than cost reflectivity in promoting competition. We also note that further analysis from NGT has concluded that Scenario A would not actually create tariffs which are significantly more stable and that this has caused NGT to revise its recommendation to the Authority. Additionally, the differences in charges produced by Scenario A compared with Scenario B are of an order (around £2/kW to £3/kW for the generation tariffs) which would suggest that it is considerably less cost reflective. We also do not believe that there is significant support for Scenario A. The responses to the April consultation show that the majority of the market, particularly as measured by the amount of energy supplied and generated, supports Scenario B.

Scenario A clearly represents a significantly inferior solution to Scenario B and should therefore not be pursued further.

The applicability of the E&W methodology to GB

It has been suggested by some that the ICRP model used for England & Wales is not suitable for use with the GB network, as the addition of the Scottish network changes the nature of the transmission system significantly. The DC Load Flow modelling used as part of ICRP takes into account the electrical characteristics of the network in determining the investment required to accommodate additional loads at different locations. There is nothing unique about the system in Scotland which would mean that this modelling is not appropriate in a GB context.

It is true that the differentials which are produced for GB are higher than those for England & Wales. However, there is currently a significant surplus of generation in Scotland. This has largely been caused by a lack of cost reflective charging in the past which has led to inefficient investment decisions being taken. This is illustrated by the problems NGT and Ofgem are having in relation to the provision of GB access rights to generators connected in Scotland. NGT has recently indicated that too many offers for transmission rights have and continue to be made in Scotland than can be accommodated within the existing GB network. It is therefore proposed that additional applications up to January 2005 will have to be accommodated ignoring the limits imposed by a number of major constraints on the network. NGT has stated that this will mean a significant increase in constraint costs. This will almost certainly lead to higher network investment costs as well.

Therefore, we would expect the methodology to produce strong locational signals indicating the high cost of accommodating further generation (or the benefit of accommodating more demand) in this part of the network. The introduction of such a signal is long overdue and is a positive outcome of the modelling, not a problem with it.

The effect of BETTA charges on Scottish generation

It has been claimed that the methodology produces results which are too extreme and particularly disadvantages Scottish generators. However, the arguments put forward in support of these claims are flawed and misleading. The two main claims made by those opposed to ICRP, and Scenario B in particular, are that it will result in a disproportionate increase in the

transmission charges of Scottish generators leading to them paying an unfair proportion of generation charges. Our reasons for believing that these claims are incorrect and irrelevant are illustrated as follows:

Claim 1: Transmission charges in Scotland will rise disproportionately under BETTA from present levels.

This claim is particularly prevalent in the paper NERA submitted to NGT on behalf of Scottish Power in late July. For example, much is made in this paper of charge comparisons for two Scottish power stations Longannet and Peterhead which are located in SPT's and SHETL's areas respectively. These stations were presumably chosen as they currently pay the minimum charge possible under the respective charging regimes and would thereby give a more dramatic impression of the sort of increase parties may face. Therefore, the analysis ignores the additional £5.52/kW Entry Charge a new entrant would presently be required to pay in SHETL's area and the estimated (in table 2.1 of SP's paper) £12.67/kW in connection charges a new entrant would presently have to pay in SPT's area. The costs used in SP's paper are £2.16/kW and £5.22/kW for Longannet and Peterhead respectively. However, the cost for a new entrant would be £14.83/kW and £10.74 respectively. In comparison the latest Scenario B charges for the relevant areas are £10.25/kW and £17.96/kW respectively.

Longannet and Peterhead's charges may indeed increase in the manner illustrated in SP's paper. However, this is in the main due to the fact that they will be moving to a shallow connection charging regime, which will increase the amount of money being recovered through TNUoS charges. Stations would normally see a corresponding decrease in their connection charges. However, if they have already paid off their connection charges then they would only see the TNUoS increase. This is no different from the changes in charges which were experienced by power stations in England and Wales, who had fully paid off their connection charges, when this form of methodology was implemented earlier this year. It is not a direct effect of BETTA.

The appendix to this response contains two graphs Fig 1 and Fig 2 which replicate figures 5.1 and 5.2 in SP's paper, but include the new entrant costs. They also include new indicative costs for Scenarios A and B contained in NGT's August consultation. Figure 5.2 in SP's paper showed the full cost of accessing the GB market by adding interconnector charges. Fig 2 in the appendix to this response shows this graph for new entrants. The new entrant cost is illustrated in Fig 1 and Fig 2 with a dotted line. Both these graphs illustrate that the costs faced by new entrants wishing to connect in the same zones as these stations and trade GB wide, will not in reality rise significantly under BETTA and will in fact reduce significantly in Longannet's zone.

Claim 2: Scottish generators will pay a disproportionate percentage of total generation transmission charges.

Again, this is a core argument made in SP's July paper. It is, however, not a relevant measure to use in respect of a system where there are positive and negative charges. The simple example below illustrates why this is so.

Imagine a system where there are 5 zones each containing equal amounts of generation. The total charges recovered from each zone under a locational charging regime are as follows:

Zone 1	£15m
Zone 2	£10m
Zone 3	£5m
Zone 4	- £5m
Zone 5	- £10m

The total amount of charges paid by generators is £15m as £30m of positive charges are offset by £15m of negative charges. Generators in Zone 1 can therefore claim that they pay 100% of total charges. This clearly gives a misleading impression when you look at the whole picture. Of course, this example is simple to illustrate the point, but it is exactly the same effect which underlies the claim made that Scottish generation will pay too high a proportion of total generation charges under BETTA.

Another, factor which contributes to the misleading nature of this statistic is the proportion of total charges which are levied on generators as a whole, as opposed to demand. Under Scenario B for example, 10% of total charges will be recovered from generators. If this were the case in the above example then generators as a whole would have been paying £15m out of a total of £150m. If the proportion that generators pay was changed to 50% then an additional £60m would need to be recovered. This would equate to £12m per zone as all zones in this example contain equal amounts of generation. Therefore, the payments being made would change to:

Zone 1	£27m
Zone 2	£22m
Zone 3	£17m
Zone 4	£7m
Zone 5	£2m

In these circumstances generators in Zone 1 would be able to claim that they pay 36% of total generation charges which would appear to suggest a significant improvement in their position. However, in reality the amount of charges they pay would have risen by 80%.

As a final illustration of how misleading this measure is, it is important to consider what would happen if the average revenue recovered from generators is set to zero, as is likely to be necessary under future EU requirements. Positive and negative generation charges would still exist, as locational charging is not precluded. However, anyone with a positive charge could claim that they pay an infinite proportion of generator charges.

Conclusions

We have seen no evidence to suggest that the adoption of Scenario B for the BETTA transmission charging methodology would be inappropriate. Specifically, it would not lead to inappropriately high charges for generators in Scotland nor lead to significant increases in charges compared with those they presently face.

The adoption of Scenario A, however, would lead to significant cross subsidies which would undermine competition and lead to inefficient investment in generation and transmission

infrastructure, as well as large increases in balancing costs. Unsurprisingly, Scenario A is supported by the incumbent companies in that part of the market which BETTA is designed to open finally to full competition. To undermine the effects of BETTA by adopting Scenario A would be a serious mistake and an opportunity missed.

Scenario B should therefore be presented to the Authority as the sole option for consideration.

Yours sincerely,

Paul Jones
Trading Arrangements

Annex – Revision of Figures 5.1 and 5.2 in SP's July paper to illustrate new entrant costs

Fig 1 - Transmission Charges for a Selection of GB Power Stations

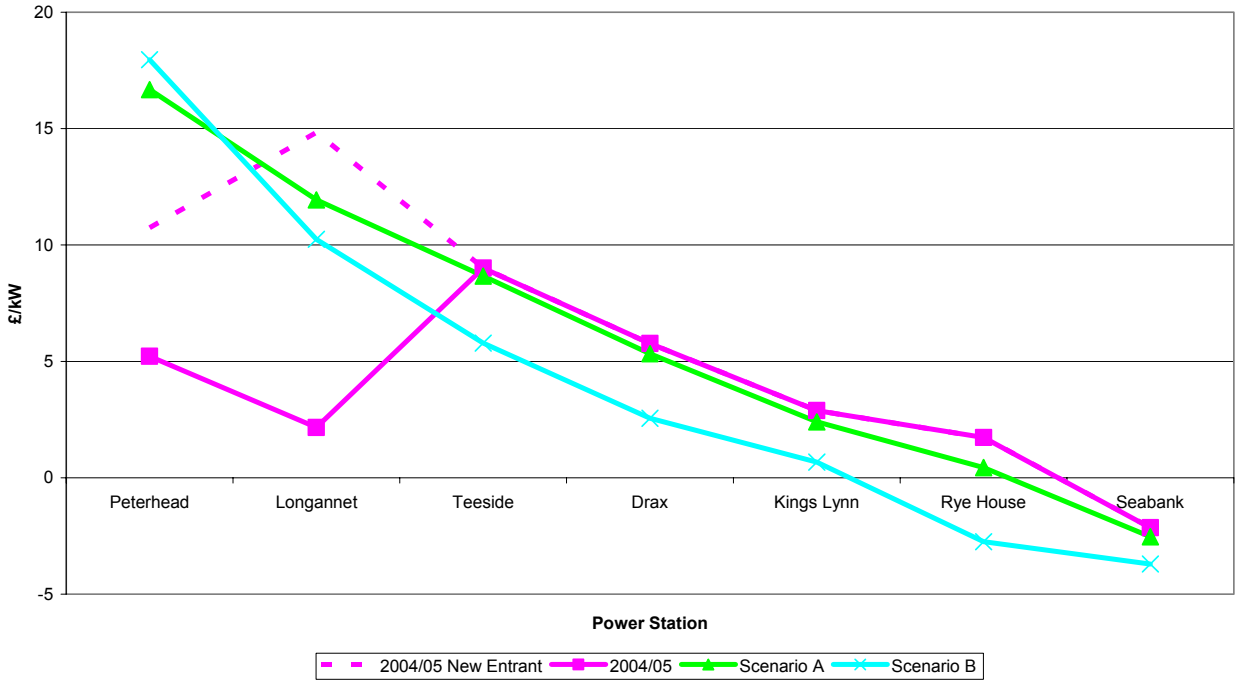

Fig 2 - Transmission Charges for a Selection of GB Power Stations Adjusted for Anglo Scottish Interconnector Charges