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Dear Craig

Consultation document

Regarding the application of the Transmission Network Use of System charging methodology for determining generation charging zones for the price control period beginning 2007/08

I am writing in response to the NGET consultation document that invites views on the appropriateness of the proposed criteria for determining generation charging zones during the next transmission price control period.

Scottish and Southern Energy remains of the view that the transmission charging methodology is in urgent need of a holistic review to address the problems that have come about largely as a result of applying the model to the 132 kV transmission system in Scotland. Indeed, we believe that the year-on-year volatility in generation charging zones and locational charges that has prompted this consultation document is further evidence in support of our view. However, the consultation document does not propose modifications to the charging methodology, rather it seeks views on the application of the methodology and it is this issue that we address here.

We agree with NGET that this is an opportune time to review the existing generation charging zones. Further, we agree that NGET's primary zoning criterion should be to determine zones that will stay fixed for the five year price control period – not least because of the certainty this would provide to generators. To achieve this, we agree that it might be appropriate for NGET to take a more forward-looking approach when determining generation charging zones. This approach is also necessary given the current proposals to base user commitment for new generators on the TNUoS tariff. Hence, it is important to publish tariffs for all potential zones and, in particular, all zones where new generators have submitted connection requests. In this context we note that the Western Isles and Orkney will have their own zones in these proposals. However, Shetland should also be included as a zone.

The forward-looking approach proposed by NGET would take into consideration the analysis undertaken for the Condition 5 report with the aim of providing stable and robust charging zones. However, as NGET points out, the forecasts in the Condition 5 report include a degree of uncertainty and are likely to change. With regards to the commissioning of new generation during the next price control period, there is particular uncertainty with regards to the growth of the renewables sector (including the development of offshore technologies), generation on the Scottish Islands, and the reinforcement and extension of the main interconnected transmission system. These uncertainties – and others – mean that it is very difficult for NGET to forecast generation charging zones and, in any given year, it is likely that there would be 'exceptional circumstances' that would necessitate a zoning review. Annual reviews would, in our opinion, undermine the certainty that NGET seeks to achieve through its proposed forward-looking approach.

Using the best forward-looking information available, NGET forecasts that 30 generation charging zones would be required during the next price control period. The number of power stations in each of these zones ranges from one to 18, with an average of less than 5 power stations per zone. The logical outcome of this approach is a transmission use of system charge unique to each node. We do not support this gradual move towards nodal charging which, in our opinion, is contrary to NGET's stated aim of achieving a stable charging regime.

This illustrates the fundamental dilemma with this charging model. On the one hand, large zones lead to relatively stable prices, but large zones are inherently less cost-reflective. This is not a problem for demand side tariffs because all suppliers operating in a given DNO area pay the same TNUoS tariff throughout the area. Hence, the locational costs of demand are smeared across a whole DNO area. This loss of cost reflectivity on the demand side does not adversely affect supply competition because all suppliers are charged the same rate.

However, the same is not true on the generation side. A new generator in a zone affects the tariff for all other generators in the zone, and this instability could be argued to adversely affect competition in generation. It is particularly the case if the new generator opts for a less secure

connection (i.e. a design variation) because the saving in cost cannot be passed directly to the new generator. NGET's proposal to address this issue is, in our view, inadequate. It leads to cross subsidy (as other generators benefit through the reduced investment) and consequently adversely affects competition in generation. Again, NGET have isolated the two issues, and in doing so has missed a further opportunity to carry out a more holistic review of Use of System charging.

While we agree that it would be appropriate for NGET to include forward-looking information in its analysis to determine generation charging zones, we do not believe that this alone will achieve zones that will stay fixed for the five year price control period. In our view, stable charging zones could be achieved by setting a smaller number of larger generation charging zones. This would be consistent with the approach taken for demand-side charging. Accepting NGET's reluctance to amend the charging methodology, the definition of larger zones would require a change to the zoning criteria for nodes to be included in a zone. If the tolerance was increased to, say, +/-£2.50/kW then around six to eight generation charging zones, rather than 30, would be required across GB (including a separate islands zone for Orkney, Shetland and the Western Isles).

In conclusion, while we support the aim of 'fixed' generation charging zones, we do not believe that the forward-looking approach proposed by NGET will result in stable generation charging zones. In our opinion, the only approach that would achieve this would be increasing the area of generation charging zones such that around six to eight zones are set for the price control period. This could be best achieved through changing the zoning criteria to a tolerance of +/- £2.50/kW, which also has the potential to address other issues that have been raised with respect to the model.

I hope these comments are helpful, and if you would like to discuss this further then please give me a call.

Yours sincerely,

David Densley
Regulation Manager