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Dear Stuart

GB Transmission Charging: Initial Methodologies Consultation

Thank you for the opportunity to comment on your recent consultation document. In summary, and further to our previous responses:

- We are disappointed that NGC has so far failed to take on board our concerns that the proposals fail to meet relevant charging objectives.
- In particular, excessive locational signals combined with the absence of any commodity component means that the methodology potentially discriminates against northern-based low load factor plant. This undermines the facilitation of effective competition in generation and supply.
- Following closer examination of the modelling and tariff setting process employed by NGC, it is apparent that cost-reflectivity can be improved. The residual charge does not reflect the value of 'non-locational' assets, and the zonal cost differentials are exaggerated.
- We would support NGC's proposal to reduce the portion of transmission charges payable by generators – this is consistent with the latest developments in EU policy. For this reason, we believe that from the two scenarios presented by NGC, scenario B better meets NGC's relevant objectives. It is also more cost-reflective.

Further, more detailed comments are provided below:

Charging Objectives

- The locational security factor has not been sufficiently justified with respect to cost-reflectivity and its application imposes an excessive burden on northern generating plant which distorts competition
- It is apparent that reinforcements made in one part of the system have the effect of reducing tariffs in that area, and thereby increasing tariffs elsewhere – this is not cost-reflective
- First Hydro believes that the proposed GB methodology (and the current E&W methodology) unduly discriminates against peripheral cable connected generation - associated tariffs provide an unnecessary closure signal, and will present a significant barrier to the development of offshore wind projects.
- The proposed methodology maintains a bias against low load factor plant. Charging for access to the system based solely on capacity at winter peak is counter to the fundamental structure of NETA. An energy-only market demands meaningful reform of transmission access arrangements to increase the level of commoditization of transmission charges. This would allow the market to function more efficiently, improving competition in generation.

First Hydro continues to believe that transmission charging should be the subject of more fundamental review to take into account issues relating to security of supply and the longer term system development needs. It should also address the implications of EU harmonization at an early stage. We do not believe that the current framework is appropriate to these issues, and indeed fails to best achieve even the existing objectives.

Issues raised in the consultation document

Notwithstanding these views, we would like to address some of the specific issues raised through the consultation document.

We note NGC's comments with respect to the G:D split. Given that EU harmonization of transmission charges is now expected to focus around "G=0", to be achieved across the EU by the end of 2008 (or perhaps earlier), we believe that the opportunity now exists to at least make progress towards this objective. Therefore we would support the application of the 20:80 split, as proposed in NGC's scenario B, and would expect this to reduce further in the following years towards the G= 0 target. It is also helpful that a reduction in the G factor resolves the issues associated with negative demand charges.

We do not agree that the use of a 'single expansion factor' as shown in Scenario A is appropriate – it is clearly not cost-reflective, providing cross-subsidies for those parties relying on lower voltage parts of the network, partially reducing tariff differentials. It is suggested by NGC that it facilitates competition by improving the stability of charges. However, for those stations connected by 400kv cable, there is no smoothing benefit and affected parties are further 'alienated' from the rest of the network. The achievement of this objective does not therefore appear to have been improved.

We agree with NGC's view that zonal charging should be maintained as opposed to nodal, to create "the right balance between stability and cost-reflectivity." However,

as we have previously pointed out, this balance is not achieved for the Dinorwig 'zone' which is in fact a single node. Again, this demonstrates that a cable-connected generator is fully exposed to the costs of its connection, without any 'correction' to address the competition objectives. Perversely these 'corrections' benefit those with 'just above average' charges, and ignore those with the highest charges.

Tariff Calculations

First Hydro has had the opportunity to run the DCLF model and has developed a version of the tariff calculation.

The tariff calculation is effectively a three stage process as described below (using a reconstruction of scenario A as a reference).

1. The locational model produces effective zonal tariffs that for generation have a range of £17/kW to -£7/kW (£24/kW range) and for demand range from £5/kW to -£14/kW (£19/kW range). The locational part of the model delivers a 'raw' revenue collection of £339m from generation and pays out £97m to demand
2. The next stage of the process is targeted at ensuring the correct G:D split (27:73 in this case) by subtracting £4/kW from each zonal tariff. The revenue collection is then £51m from generation and £133m from demand.
3. A residual tariff calculation is then performed that adds £3.5/kW to generation tariffs and £11.2/kW for demand. This calculation is targeted at ensuring the correct overall revenue is collected, and shifts zonal tariffs up (maintaining original ranges) to achieve this.

We have several initial observations (relevant to both scenarios):

- **The residual charge appears not to be cost-reflective**
It bears no actual relationship to any element of NGC's costs. If it is not related to residual assets it follows that the locational element of the charge is not related to the locational costs.
- **There is no justification for 'shifting' of raw locational tariffs to preserve differentials**
Given that the raw cost data over-recovers revenue from generators, it would seem more appropriate to scale tariffs down to the target revenue.
- **Perverse locational signals in peripheral zones.**
It is apparent that locational tariffs for peripheral connected generation do not provide the correct signals. Reducing TEC at these locations simply increases the locational charge. This is especially noticeable for northern generation and leads to the situation where additional northern generation actually reduces tariffs.

These observations would seem to support our earlier comments – there are sufficient flaws in the current approach to suggest that a more fundamental review of transmission charging should be pursued.

We hope that these comments are useful – should you require any further information then please contact Simon Lord or myself.

Yours sincerely,

Kevin Dibble
Director, Marketing