

17 November 2010

Stuart Cook
The Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

Dear Stuart,

Project Transmit: A call for evidence

Consumer Focus is the independent champion for consumers across England, Wales, Scotland, and for postal consumers in Northern Ireland. We operate across the whole of the economy, persuading businesses and public services to put consumers at the heart of what they do.

The focus of our response is on the aspect of Project Transmit related to electricity transmission charging, and particularly Transmission Network Use of System (TNUoS) charging, as this is where we believe the impacts of potential changes to the current arrangements could result in greatest material differences for end consumers. However, we note generally that a key ambition for Project Transmit should be to ensure that risk and reward is correctly allocated between consumers and industry participants. This is important so that consumers do not end up picking up the tab for inefficient industry investment, whilst at the same time incentivising the industry to make efficient investments to meet consumer demand. This is the case regardless of whether the issue is related to electricity or gas transmission or the charging or connections arrangements. Our response provides views and calls for evidence with regards to four main areas.

These are:

- whether the objectives of Project Transmit are appropriate
- whether the principles on which the current charges are derived remain fit for purpose given the new and emerging challenges the energy sector faces
- whether the current arrangements deliver value of money to energy consumers
- whether the current arrangements facilitate appropriately the connection of low carbon generation including renewable and any other new generation

1. Whether the objectives for Project Transmit are appropriate

We believe the time is right to take a step back and consider from first principles whether the current transmission charging and related connection arrangements, formulated in the 1990s, are meeting current energy objectives as well as whether they are likely to meet future energy objectives.

We believe the objectives that Project Transmit intends to judge the current arrangements against are sensible. Delivering safe, secure and high-quality network services which are: 1) compatible with the need to ensure the shift to a low-carbon

energy sector and security of supply and 2) met at the least cost for existing and future consumers; is an appropriate ultimate objective. We place extremely high importance on incentivising the energy market to select the least cost option (assuming a given level of quality) to ensure the total cost to consumers (generation, network and supply) is kept to the minimum required.

We also consider it essential that Project Transmit is conducted in a manner which takes into account the work being undertaken by DECC for the Electricity Market Reform programme as well as the electricity and gas transmission price control reviews (RIIO-T1). This should help ensure that all the regulatory activity being undertaken by different bodies is consistent with the need to ensure end consumers receive value for money.

2. Whether the principles on which the current charges are derived remain fit for purpose given the new and emerging challenges the energy sector faces

We are of the view that the transmission charging and connection arrangements should incentivise the least cost option needed to deliver the network services and energy that customers require which also meet the UK Government's environmental obligations. To ensure that the least cost option is incentivised National Grid's 'relevant objective' under its Transmission Licence compels it to 'facilitate effective competition in the generation and supply of electricity and (so far as is consistent therewith) to facilitate competition in the sale, distribution and purchase of electricity'.¹ This objective is consistent with ensuring that competition is encouraged in the electricity market to ensure that the least cost option is incentivised reducing the total cost to end consumers.

To help facilitate effective competition it is appropriate that costs are correctly allocated to market participants in relation to the costs they impose on the wider market ie that prices are cost reflective. Therefore it is appropriate to align transmission charges, as practically as possible, with the underlying costs which market participants impose on the transmission system. To this end an element of TNUoS charges is set on a locational basis. The underlying rationale behind TNUoS charging is to ensure that the costs borne by market participants reflect the long run incremental costs they place on the transmission system which should provide efficient economic signals which will reduce the total cost (generation and transmission) to the minimum required of end consumers.

Only if such a principle reduces the total cost to all consumers do we believe it is acceptable that end consumers located in different regions of the country should be charged different amounts in relation to underlying costs. Even in such circumstances there might be a need to mitigate or cap regional price differences if these would otherwise create significant affordability issues in any region. We will therefore expect to see evidence that you have considered the distributional impact (both by region and by type of user) of alternative methodologies as well as their total cost.

¹ SLC C5(5) of National Grid Electricity Transmission's Electricity Transmission Licence

We note here that a previous consultation exercise undertaken by National Grid between November 2008 and September 2009 (GB ECM-17²) discusses many of the issues which will need to be considered by Ofgem so it is in a position to judge whether the principles underlying the calculation of the current charges remain fit for purpose. Updated information provided in this consultation exercise (including the ability of renewable generation to connect to the transmission network and whether the current Investment Cost Related Pricing methodology is cost reflective) is essential to ensuring that Project Transmit can meet its objectives. We would also like to understand the currently differing proportions between the generation and demand tariff (currently split 27 per cent for generation and 73 per cent for demand) and whether these proportions are still justified by the relevant costs.

The final point we would like to make on the principles of TNUoS charging is that any consideration of the advantages and disadvantages of particularly transmission charging methodologies must consider the generation and demand tariffs together not separately (for example the Scottish Government's proposals contained in the GB ECM-17 consultation only considered the generation tariff). The imbalance of resources between consumer and industry representation has meant that the focus of the debate on locational charging has historically concentrated on the effect that it has on generation, with lesser scrutiny of any impact it may have on demand. We will expect you to provide evidence on, and consider the impact of, different charging approaches to consumers (both regionally and nationally) as well as on generators. It is our view that if there are difficulties for generation in responding to locational price signals, the ability for all except the largest electricity users to respond to price signals is even weaker. This fact must be recognised in the Project Transmit review.

3. Whether the current arrangements deliver value for money to energy consumers?

In 2009 National Grid were of the view that without locational price signals 'the minimum (generation plus transmission) investment cost solution is unlikely to be achieved and that additional transmission investment costs are likely to be incurred, that will ultimately be paid for by the end consumer'³ by moving to a uniform transmission charging methodology.

In any case we are not best placed to provide a definitive judgement on whether the current arrangements have delivered value for money to energy consumers. However, one of the priorities for Project Transmit should be to understand what the total costs (and how costs are distributed between different consumers and market participants) incurred by consumers are likely to be under the current as well as alternative

² The Scottish Government in 2008 (in conjunction with ScottishPower, SSE and the Scottish Renewables Forum) made the claim that TNUoS tariffs are unstable, unpredictable and highly volatile which deters necessary investment. Furthermore the current methodology discriminates against the development of renewable generation. The Scottish Government recommended that the current locational TNUoS charging methodology be replaced by one based on uniform TNUoS charging on a commodity rather than capacity basis. National Grid came to the conclusion that these claims could not be substantiated as there was little evidence to support the Scottish Government's position. As such National Grid decided not to proceed with the Scottish Government's proposal <http://bit.ly/9i38Eh>

³ National Grid, GB ECM-17, Transmission charging – a new approach, A proposal from ScottishPower, SSE, Scottish Renewables Forum and the Scottish government (May 2009) p24

arrangements. Unsurprisingly the arrangements which are likely to ensure the least cost approach will be the most appealing to Consumer Focus.

4. Whether the current arrangements facilitate appropriately the connection of low carbon generation including renewable and any other new generation

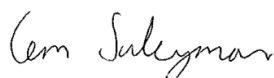
We would like to note that National Grid stated in the Conclusion report of the GB ECM-17 consultation exercise that the current TNUoS charging methodology was not inhibiting the development of renewable generation.⁴ The provision of quantitative evidence to support claims that the current arrangements are or are not facilitating particular types of generation should be a high priority for Project Transmit.

Furthermore, any analysis should be considered in conjunction with current policies aimed at encouraging the development of particular forms of generations, such as the Renewables Obligation, and other potential changes which could incentivise low-carbon generation (such as a Contract for Difference for the Climate Change Levy to provide a floor price for carbon as envisaged by the current Government).

Consideration should also be given to the potential disadvantages of instituting remedies in the transmission charging arrangements. These could lead to market distortions which could potentially increase total costs for consumers, and could also lead to windfall losses and gains for market participants that are unrelated to underlying costs. As such measures to incentivise particular types of generation outside the transmission charging arrangements should be considered as alternative options. This is because such measures have the potential to ensure the total cost to consumers is kept to a minimum.

I hope these comments are helpful. If you would like to discuss these comments further I would be happy to follow them up with you either in person or via telephone/email (cem.suleyman@consumerfocus.org.uk, 020 7799 7932).

Yours sincerely,



Cem Suleyman
Senior Policy Advocate

⁴ National Grid, GB ECM-17, Transmission charging – a new approach, A proposal from ScottishPower, Scottish and Southern Energy, Scottish Renewables Forum and the Scottish Government, Conclusions report (September 2009) p30