



Tracey Hunt
Competition & Trading Arrangements
Office of Gas and Electricity Markets
9 Millbank
London
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12th November 2003

Dear Ms Hunt,

Reference: Transmission Investment and Renewable Generation – Consultation Document

Powergen is in agreement with Ofgem that in order to facilitate significant growth in renewable generation, it is necessary to improve the existing signals and incentives for transmission network operators (TOs). Such changes will not only be reflective of government policy, but will also seek to ensure that sufficient entry capacity is made available in an efficient and expeditious manner. We also agree that where possible price controls should not be adjusted once set, as this reduces an incentive on TOs to better their targets. However, with this particular issue it may be appropriate to adjust the existing controls, provided that:

- there are strict controls to prevent over investment by TOs;
- sufficient notice is given to all appropriate parties;
- investment is apportioned in a controlled, efficient and equitable manner (so as to avoid the setting of perverse incentives).

This response covers the issues discussed in section four of the consultation paper and represents our initial view on the generic questions raised by Ofgem.

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Assessment of the three proposed solutions.

Option 1: Rely on existing mechanisms:

- Utilising existing mechanisms is likely to result in a substantial funding gap, which will need to be addressed at some point. To delay the recovery of the necessary investment may hinder the development of infrastructure.
- Conversely, the development of renewable generation itself may be restricted if TOs decide to use a deep connection policy as a means of meeting the funding gap.

Option 2: Re-open the price controls:

- It is not clear how a definitive figure can be attributed to renewable investment costs going forward.
- May reduce incentives on TOs to perform, if a price control 'second chance' is perceived to be available.
- To re-open price controls will increase market uncertainty.

Option 3: Add an additional mechanism:

- An additional mechanism could be tailored to give a high degree of cost reflectivity. A sophisticated methodology may also facilitate efficient outcomes.
- A sophisticated recovery mechanism could take too long to develop. However, it may be possible to devise a quick fix which adequately recovers costs in the short term.
- Whichever mechanism is considered the most appropriate, protection against over investment is paramount. Control mechanisms must be put in place to prevent unnecessary expenditure and the discriminatory costs caused by such inefficiency.



It is arguable whether either of the scenarios likely to arise from the inaction associated with option one could be considered as satisfactory. The first option also appears to be problematic for the Authority, given that Ofgem has a statutory duty to have regard to the need to secure that transmission licensees can finance efficiently incurred expenditure. It therefore seems appropriate to consider which of the remaining two options is likely to provide the transmission licensees with the most robust incentives to improve efficiency. We believe that to reopen the current price controls could weaken the efficiency incentives placed on TOs. It has also been noted that such an approach may be incompatible with the BETTA timetable. Our initial view therefore, is that the latter option appears to offer a workable solution provided that sufficient controls are in place to guard against over investment.

If renewable generation is to meet government targets there must be a mechanism for the TOs to invest in reinforcement without the need for an individual developer to secure the transmission investment. However, the need for this investment must be carefully assessed and proven, not least because it would only be prudent to minimise the risk of stranded assets. The emphasis should be on reinforcement that does not rely on any one individual scheme going ahead, but where there are several schemes any of which would require the reinforcement. It might be prudent for the Authority in conjunction with the TOs to set a renewable generation capacity level/threshold (taking account of appropriate variables) which could be used to trigger efficient investment in the transmission infrastructure. It does not make sense for a TO to spend significant amounts of money to reinforce its network just because a small renewable generator wants to connect a negligible load and pass on the cost to its customers.

In conclusion, we recognise that unforeseen transmission investment attributable to renewable generation does need to be recovered by utilising one of the three suggested methodologies, and that this assertion is based on grounds of efficiency, as proposed by the authority. It is therefore imperative that efficiency incentives are ultimately at the heart of the adopted mechanism.

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It should also be noted that an accurate assessment is restricted by the currently unresolved Scottish transmission/distribution connection question. Whatever the decision, Ofgem should seek to ensure that the additional costs are audited and verified to be correct, without any hidden cost or cross subsidy from other TO operations. Care should be taken that supplementary charges are cost reflective.

Yours sincerely

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