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David Halldearn
Director, Scotland and Europe
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GCHPL-B100-0015

Dear Mr Halldearn

December 2003 Consultation Paper: The CUSC under BETTA

Fortum Group, owner of Grangemouth CHP Ltd, welcomes the opportunity to respond to this consultation.

Implementation of CUSC arrangements for BETTA

We welcome Ofgem / DTI's confirmation that the CUSC forms a central part of the GB arrangements and therefore must be implemented at the same time as the rest of BETTA. However, we would wish to stress that the CUSC alone is insufficient to provide the connection and use of system aspects that are necessary for BETTA. We would like to reinforce the comment reported at para 4.82 and other comments of similar theme reported throughout the consultation paper: that the establishment of a working set of arrangements under the CUSC is a task of significant magnitude and that the process by which this will be achieved once the CUSC framework its self has been largely finalised is not yet clear.

Interconnector Arrangements

We welcome the statement in para 4.169 regarding the existence of dialogue in relation to the Moyle Interconnector. In the interests of facilitating ongoing operation of an effective market, some widely available clarity regarding the plans relating to the Moyle Interconnector, the likely outcome, and progress towards that outcome, would be welcome.

Significant reform to transmission access and charging

We note Ofgem / DTI's comments in relation to the need to meet obligations to continue the development of both the existing arrangements and the BETTA arrangements, but we strongly support the comments made in para 4.36 and throughout the paper, that major changes to the existing England and Wales CUSC should not be attempted until it is possible for them to be fully considered and understood in the context of the finalised GB arrangements. The large number of issues which have been raised by consultees and which are summarised in the current paper, coupled with the lead-times associated with the steps to address them which have been identified in the paper, tend to underline the complexity of the task ahead and the undesirable impact of undertaking any major reform that can be avoided.

Transmission Access and Charging

We note the current approach which is being followed in the development of transmission charging methodologies for BETTA, and in accordance with that approach will respond to National Grid's consultations on the development of the methodology. However, we would wish to comment on the overall direction of the process in the context of this CUSC consultation. Given the historical relationship between the England and Wales charging methodology and the licence conditions which underpin it, combined with the relatively short period in which the BETTA methodology is to be developed, there will effectively be a strong presumption in favour of extending the current England and Wales methodology to cover Scotland.

We support the broad principle that GB users should pay for the GB system with cost-reflective and non-discriminatory cost recovery on a GB-wide basis rather than sub-divided within GB. However, we have concerns regarding the choice of methodology for establishing cost-reflective use of system charges, both because of the practical effects, and because of the basis of the methodology its self.

In practical terms, we note that the application of the existing use of system charging methodology outlined in National Grid's recent Initial Thoughts paper will result in very substantial departures from historically established norms for levels of use of system charging, with any sensitivities around the default case still being swamped by the step change from those norms. Changes of this magnitude, especially against a historic background of stable UoS charging regulation and increasing transmission system cost efficiency in Scotland, are likely to leave generation assets in Scotland stranded by virtue of UoS charging far in excess of that provided for in their financing.

We see this practical side-effect as indicating that the existing England and Wales use of system charging methodology may not be applicable to the full GB system. The current England and Wales methodology, modified as proposed in the current consultation document, is not the only methodology which could be said to be cost-reflective, and in fact contains shortcomings which – whilst evidently tolerable in an England and Wales context – render it punative in the context of the GB system. Those shortcomings have their origins in basing the charges at a particular zone on the incremental cost of the next capacity to be connected at the zone, rather than on the cost of the capacity already connected. One consequence of the particular methodology which has been chosen is the creation of unrealistically sharp locational signals at nodes towards the periphery of the system.

We note Ofgem's analysis of the total impact of transmission charging on generators under BETTA, published on 5 February 2004, which identified that the £ per kW use of system charge was not the only factor affecting the position of generation (and demand) under BETTA and concluded that Scottish generation in aggregate would be marginally better off (GBP 5 million per year) under BETTA charging than under the current arrangements. This analysis, whilst contributing to the debate, does not give a fully balanced picture. Some additional issues which might be considered include:

- ***Relevance of Scotland-England interconnector***: In theory, and in the absence of any other influences on market prices, the impact of use of system charging on the Scotland-England interconnector would be expected to be reflected in the market value of electricity in Scotland, even for market participants which were not directly exposed to those interconnector charges. However, the Scotland-England interconnector is not the only interconnector linking Scotland. Further, the market value for electricity (to the extent that a single identifiable market exists, given the low liquidity and strong influence of structural factors on the transactions which are feasible) is not necessarily determined primarily by reference to Scotland-England interconnector charges.

- ***Geographic Spread***: The analysis does not take account of the geographic spread of generation in Scotland which, taken together with consistent application of charging zone criteria throughout GB, could result in significant variations in the relative positions of certain Scottish generation and demand before and after BETTA.

- ***Class of generation and demand***: The current Scottish Trading Arrangements place generation and demand belonging to the "host" companies on a fundamentally different footing to independent generation and demand – not necessarily in terms of transmission charging, although there is effective differentiation on this in the North of Scotland area – and therefore any analysis of the impact of BETTA should recognise the implications of this differentiation.

If the first point is acknowledged then it will be concluded that the aggregate effect of the BETTA reforms will be adverse on Scottish generation. If the second and third are recognised then it will be recognised that within the overall picture there may be some extreme outcomes which in detrimental cases may leave existing generation assets in Scotland stranded by virtue of UoS charging far in excess of that provided for in their financing and provide a sharp disincentive to any new generation assets.

In the interests of longer term certainty and regulatory stability we would wish to see a set of licence conditions and a consequent methodology which result in a use of system charging methodology which of its self meets Ofgems stated objectives whilst striking the right balance in terms of wider impacts. We are strongly opposed to the creation of circumstances which result in a methodology which brings with it specific problems which are then the subject of additional specific measures to address those problems – which appear to be a possible consequence of the August 2003 consultation on Transmission Charging, coupled with the conclusions on Transmission Licences. If this latter approach is to be adopted then, for reasons which are perhaps apparent from the company name, we would wish to see the definition of generation which benefited from specific measures to be drawn sufficiently wide as to encompass generation which was not solely renewable (because the wider

environmental benefits follow from CHP generation as from renewable) and not solely restricted to small generation (because the impact of the use of system charging scales with the size of the generating station).

We would be happy to expand on our views should that be required.

Yours sincerely

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Asset Manager