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**Zonal transmission losses – assessment of proposals to modify the Balancing and Settlement Code
 February 2007**

Dear Bob,

We welcome the opportunity to comment on the issues raised in this Impact Assessment and consultation. This response reflects the views of RWE npower and the UK based business of RWE Trading GmbH.

The document analyses the impact of the four proposals, and two alternatives to change the transmission losses charging arrangements from the current uniform methodology to one determined on a locational basis. We endorse Ofgem's approach in separating out the direct and indirect impacts of the proposals and are pleased that Ofgem has considered the wider implications, particularly for the environment. However, the Impact Assessment does not explicitly discuss or evaluate crucial arguments in favour of locational losses that have previously been supported by Ofgem, such as the current cross subsidy from southern generation to northern generation and from northern generation to southern demand and it is not clear why. These remain compelling arguments in their own right.

In our view, the existing locational split between northern generation and southern demand is neither economic, efficient, nor good for the environment, since it results in the transportation of electricity over large distances which increases the amount of energy lost through variable losses. We believe that losses should be applied on a non-uniform locational basis reflecting each party's contribution to such losses. Implementation of a zonal transmission losses scheme would address these concerns and provide the appropriate economic signals to site new generation closer to existing demand (and vice versa), since it would target the costs of such losses on those parties who cause electricity to be transported the furthest distance. This will remove the cross-subsidy, whereby southern generators and northern suppliers have to pay part of the costs of transporting electricity to the south. A further benefit is that it will lead to more

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efficient and economic short-term plant generation decisions and long-term plant investment decisions.

We would further argue that introducing a zonal losses scheme will enable NGET to meet better its licence objectives. Objective (a) would be better facilitated by the removal of the market distortion created by the uniform charging for transmission losses and charges for variable transmission losses will be less discriminatory as they will correspond more closely to the extent to which BSC Parties cause them. Objective (c) will also be better facilitated, as cost-reflective charging for variable transmission losses will enhance competition.

We continue to support P203, the seasonal zonal losses scheme and P198 the annual zonal transmission losses scheme. Both these modification have significant benefits in terms of the incentives to reduce total losses on the transmission system, as indicated in Table 2.3(a)¹ and the reduction in overall transmission costs. On the basis of the analysis presented, the clear implication is that P203 would produce the greatest benefits. In addition, there are environmental benefits under all the proposals, with the greatest impact being under P203.

We do not support either of the phasing schemes proposed in P198 Alternative (linear phasing) and P200 (f-factor phasing) since they delay the benefits of the zonal transmission scheme and preserve the current cross subsidy that arises under the uniform scheme. In any case, the assessment presented by Ofgem tends to suggest that neither of the proposals is as good as the others in reducing total losses. While P204 may contribute to the reduction in losses, it will maintain a form of cross subsidy and perhaps crucially it will have a much lower impact on carbon, SO_x and NO_x emissions when compared with P198 and P203, as set out in Table 4.1.¹ A further weakness of P204 is its adverse impact on the accuracy of TLFs by removing the principle that the scaling factor (0.5) is designed to reflect the difference between fixed and variable losses.

In conclusion, based on the analysis presented together with the positive cost-benefit we believe that the uniform transmission losses arrangements need to be replaced by those based on a locational basis. Of the options being considered as part of this Impact Assessment, P203 in particular delivers considerable benefits and we commend the Authority to implement this modification.

We hope these views are helpful and if you wish to discuss them further please contact me on 01793 893983.

Yours sincerely,

Charles Ruffell
Economic Regulation

¹ Zonal transmission losses– assessment of proposals to modify the Balancing and Settlement Code, Ofgem February 2007