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Dear Karron,

Recovering the costs of compensation for temporary physical disconnection (CAP048) – proposed modification of transmission licences

I am writing in response to Ofgem's open letter consultation dated 19th October 2007, inviting views on the proposed modification of transmission licences in order to recover the costs of compensation for temporary physical disconnection (CAP048). We welcome the opportunity to provide our comments following Ofgem's earlier open letter consultation and minded to statement in March of this year.

As indicated in our responses to Ofgem's previous consultations on this issue, we agree with the principle of introducing a mechanism in order to recover the compensation payable under CAP048 and we welcome Ofgem's decision that the funding mechanism should not be overly complex. We note that Ofgem recognises the view expressed by many of the respondents to the previous open letter consultation and minded to statement that to share responsibility between GB System Operator (GBSO) and the Transmission Owners (TOs) would be problematic.

However, in this open letter consultation it is proposed that the cost recovery mechanism should be solely through the Transmission Network Use of System (TNUoS) Charging Methodology; and we are strongly opposed to this proposal.

The TNUoS Charging Methodology is required, in accordance with Standard Condition C5, to *"result in charges which reflect, as far as is reasonably practicable, the costs (excluding any payments between transmission licensees which are made under and in accordance with the STC) incurred by transmission licensees in their transmission businesses"*. We do not agree that compensation payable under CAP048 is a cost incurred by the transmission licensees in their transmission business. Rather, we believe that these costs are incurred by National Grid in its role as GBSO. As such, in our opinion, these costs should rightly be recovered through the Balancing Services Use of System (BSUoS) charge.

In our view it is inappropriate for the GBSO to determine and make payments to users for temporary physical disconnection to the network, and then subsequently invoice the TOs for this amount (who are otherwise not exposed to the financial transactions in relation to the disconnection). The TOs would then, we presume, be required to make this payment to the GBSO and seek to recover the monies back from the GBSO through their regulated income. The GBSO would therefore need to include this value when setting TNUoS tariffs. In our view this is an unnecessary, bureaucratic process which adds an additional administrative burden to the TOs when the costs could be recovered directly by the GBSO through BSUoS.

Furthermore, if the cost recovery is to be through TNUoS charges, then changes to the System Operator – Transmission Owner Code (STC) to enable the GBSO to invoice the TOs for these costs will be necessary. These have yet to be developed. As a consequence, it is not clear if administrative costs will be added during the process. Furthermore, the proposed licence modifications for Scottish Power Transmission Limited (SPTL) and Scottish Hydro Electric Transmission Limited (SHETL) state that the GBSO will charge the TO in accordance with the STC. For this licence modification to be enacted, a modification to the STC would be required at the same time.

We also note that the proposed licence modifications for SPTL and SHETL would require the TOs to recover these costs in the same year as they are incurred. This would require the TOs to make accurate forecasts of these costs the previous year. Given that it is highly unlikely that the TOs would be able to do this for what are uncertain and unpredictable payments, we question whether this is the most efficient mechanism to implement this policy. It is not appropriate for TOs to be exposed to potential punitive interest payments on under or over recovery of regulated income when they have no control over the level of these charges. At the least, if Ofgem are insistent that these charges are recovered through TNUoS, they need to be in arrears.

Finally, we note Ofgem's view that it may be appropriate to develop an enduring incentive regime when more data on costs are available, with it potentially being implemented in April 2009. In the first instance, we would have concerns about the value of such an incentive regime given the very limited data available. In that regard, we welcome Ofgem's acknowledgement that setting an incentive would be difficult due to the lack of relevant data, and the implications of doing so could result in targets being set too low or too high. Furthermore, we are unclear as to the purpose of an additional incentive regime given the existing TO reliability incentives. We understand that the GBSO and TOs are actively investigating mechanisms that could be implemented under the STC to further improve the availability of the GB Transmission System.

We hope that Ofgem considers fully the points raised in this letter before making any final decisions regarding the method by which the costs of compensation should be recovered.

If you have any questions or would like to discuss our response further then please do not hesitate to call me.

Yours sincerely,

Malcolm J Burns
Regulation Manager