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Dear Dena,

GB ECM-18 – Locational BSUoS Charging Methodology

ESB International (ESBI) welcomes the opportunity to respond to Ofgem's regulatory impact assessment (RIA) on National Grid Electricity Transmission Ltd's (NGET) proposal to modify its transmission charging methodology to introduce location BSUoS. As an independent developer of efficient conventional and renewable electricity generation, the issues and questions raised in the RIA are key considerations and could critically impact our business.

ESB International

ESBI has been a developer of independent generation projects in the GB market for over fifteen years. We currently have interests in the 350MW Corby power station, in the 850MW development at Marchwood, which commissioned late last year, and have recently announced our latest 860MW development at Carrington and 960MW Centrum development in Burton upon Trent. It is ESBI's intention to build 3GW of thermal generation in Great Britain in the next decade.

In addition to expanding our conventional generation portfolio, we are also seeking to expand our GB portfolio of renewable generation sites, having recently announced the acquisitions of Fullbrook Down and West Durham windfarms. All these developments are set within the context of a wide-ranging programme announced by the ESB group to facilitate the transition to a low carbon economy.

Summary of views

Although ESBI supports the general principle of locational signals within transmission network charges, we do not support the proposal for locational BSUoS being raised as part of GB ECM-18. We discuss some general concerns below and then provide views on whether the proposal better facilitates NGET's relevant licence objectives.

GB ECM-18 was raised in response to significant recent increases in the cost of managing constraints on the GB transmission system. These have arisen as a result of significantly more generation connecting to the network than it is able to currently accommodate. For various reasons, the Transmission Owners have been unable to deliver sufficient infrastructure to accommodate the significant increases in both conventional and renewable generation that has been seen and is forecast to continue over forthcoming years.



A fundamental assumption underpinning the proposal to incorporate a locational element in the BSUoS charge for those users that sit behind a GB SQSS derogated boundary is that those users will change their generation behaviour at times of constraint, therefore reducing that constraint and the associated cost. We are of the view that the proposal would not result in the changes in behaviour assumed within the proposal, except where the generation sitting behind the derogation comprises of only one or two generating companies with diverse portfolios. Generators located within a derogated constraint zone in which there are many other generators would be unable to accurately forecast the periods at which the constraint behind which they are located would be active and the associated cost. Indeed for some technologies (such as wind), it may be the case that they have no choice but to generate (at times when wind conditions are favourable, for example).

Further, the proposal relies on a cost signal to influence generator behaviour. GB ECM-18 assumes that when constraints are active across a derogated boundary, generators subject to the locational BSUoS charge would alter output to avoid the increased charge. We are of the view that this would not happen due to the ex-post nature of the charge calculation. It is not appropriate to assume that generators will be able to forecast either constraint occurrence or constraint costs behind their respective boundaries prior to them arising. For some generators, this is further compounded by situations involving nested constrained boundaries.

GB ECM-18 is governed by the bi-lateral process between NGET and Ofgem for the derogation of certain system boundaries from the GB SQSS. Derogations are applied to boundaries unable to accommodate the full flows across them due to insufficient levels of infrastructure. We note that the process by which NGET applies for, and Ofgem grants, derogations is not transparent and gives rise to significant uncertainty for both existing and new generation. In particular, industry is not made aware of boundaries subject to derogation applications nor is there clarity on the decision process adopted by Ofgem. We believe GB ECM-18 could only be adopted, if industry were to have considerably more clarity on the derogation process and complete certainty around the period for which they would apply.

We are of the view that the uncertainty inherent in the current derogation process is particularly pertinent for new generation. The GB energy market is in a period of major change as its participants strive to meet Government environmental targets whilst ensuring security of supply. Significant amounts of new renewable and cleaner, flexible thermal generation are required to meet these goals. The uncertainty within the derogation process is already a factor in investment decisions for new generation. Should GB ECM-18 be introduced, the increased risks associated with the derogation process would more than likely deter crucial investment which would otherwise be economic and viable.

The Department of Energy and Climate Change (DECC) is part way through a process to develop and introduce enduring arrangements for transmission access. Since Ofgem issued its RIA for GB ECM-18, DECC has provided an indication that it is minded to adopt a "Connect & Manage" model with any additional costs of constraints fully socialised across all users. In its RIA, Ofgem notes that the DECC process could supersede GB ECM-18 if it did not fit with its chosen model. As such, we would like full clarity on Ofgem's position regarding locational BSUoS were DECC's fully socialised access model to be introduced.

Cost-reflectivity

During the last 2-3 years, NGET has provided a large number of varying forecasts for incremental constraint costs (particularly those caused by accelerated connections). The variations in these forecasts are attributed to a number of reasons, but one key factor was the difficulty NGET has in allocating specific operational actions to the management of specific constraints. Indeed, significant effort was put into this as part of the work undertaken during the Transmission Access Review with little progress made on accurately attributing specific actions and costs to constraints. We are therefore concerned that the costs which would feed in to the locational element of BSUoS under GB ECM-18 will not accurately reflect the true costs of managing constraints and would subsequently provide inaccurate or inappropriate signals to generators.

GB ECM-18 proposes a reduction in the locational element of the TNUoS tariff for those generators sitting behind GB SQSS derogated boundaries. This short-fall in revenue would be



recovered through the TNUoS residual for all generators not subject to locational BSUoS. This adjustment is justified on the grounds that those paying locational BSUoS do not have the full access rights assumed with TEC and as such should not receive the full TNUoS charge.

We understand that, as part of the interim access regime, NGET has applied for a number of derogations against the GB SQSS. Were a number of large areas of the network (in addition to Scotland) to be derogated, we are concerned that those generators that have situated in areas of the network that are not constrained (ie more economic) will be penalised for that decision by picking up significant increases in the residual element of the TNUoS tariff. By picking up (possibly) large amounts of unrecovered revenue within their residual TNUoS charge, we are of the view that GB ECM-18 could have the unforeseen consequence of undermining the cost-reflectivity of the TNUoS charge.

Competition

In its RIA, Ofgem repeatedly states that GB ECM-18 will result in more stable BSUoS charges for users. We do not agree that this would be the case, particularly for the reasons discussed above relating to generators ability or willingness to react to the signals intended under GB ECM-18. Volatility in BSUoS is predominately driven by generator behaviour and we are of the view that it would only be compounded by the introduction of locational BSUoS in the form proposed under GB ECM-18.

Additionally, it is our view that larger portfolio generators, particularly where they have diverse portfolios in proximate locations, may be able to take advantage of that position by manipulating generation output to ensure minimum exposure to a locational BSUoS. This would be in addition to also benefitting from reduced TNUoS at those sites. Independent generators would not have the same ability to do this, particularly those with portfolios of inflexible generation technologies (such as wind).

Facilitation of competition and non-discrimination are fundamental to both NGET's charging objectives and Ofgem's duties. Any increase in regulatory or cost uncertainty is detrimental to new investment and therefore competition in the markets for electricity generation and supply. This is particularly the case for independent developers and generators who have less opportunity to mitigate the uncertainty through the use of diverse portfolios and supply positions. Further, for smaller market participants with greater reliance on external funding, any additional risk or uncertainty must be factored into investment proposals and may well mean that otherwise economically viable plant is unable to proceed to the detriment of market competition and diversity.

Security of supply

We have already stated that we are of the view that GB ECM-18 will not have any material impact on generators' behaviour. As such, we do not think the proposal will have much impact on current and future security of supply. It may have the effect of changing the position of some plant or technologies in the merit order (if NGET's assumptions prevail) but we do not think this will weaken nor improve security of supply. GB ECM-18 will redistribute the current and forecast constraint costs amongst users. The proposal will not reduce BSUoS costs but could significantly increase financing, investment and operational costs for generators. As such, there will be little benefit for the increased costs that are ultimately borne by customers.

In conclusion

ESBI does not support the implementation of GB ECM-18. We are of the view that it introduces significant regulatory and cost uncertainty for both new and existing generators and as such is not consistent with better facilitating competition. We also have concerns over the cost-reflectivity of the new locational element of the BSUoS charge and the possible impact on the cost-reflectivity of the TNUoS charge levied on those generators not sitting behind a GB SQSS derogated boundary. Fundamentally, however, we do not believe that the modification will result in the intended benefit of materially changing the behaviour of generators sitting behind derogated boundaries.



Should you wish to discuss any of the issues raised in this response, please do not hesitate to contact me.

Yours sincerely,

Michael Dodd
GB Regulation Manager

