

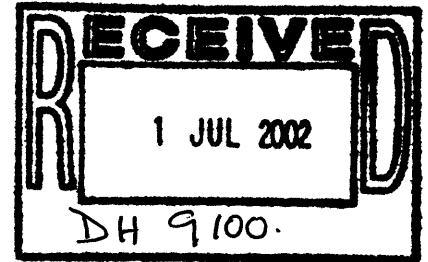


CONFEDERATION OF UK COAL PRODUCERS

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18 June 2002



David Haldearn
Director – Scotland and Europe
Office of Gas and Electricity Markets (Ofgem)
9 Millbank
London
SW1P 3GE

Dear Mr Haldearn

The Development of British Electricity Trading and Transmission Arrangements (BETTA)

Ofgem/DTI Report on consultation and next steps

The Confederation of UK Coal Producers (Coalpro) represents member companies who produce over 80% of UK coal output. The great majority of this production is sold to the electricity generation industry. Coalpro therefore takes a close interest in all developments affecting that industry and has supported the introduction of NETA and Ofgem/DTI's objectives in maximising competition in the electricity and gas industries.

The introduction of NETA has seen a reduction in wholesale electricity prices and an increase in coal consumption at power stations. This is not coincidental. It has occurred because NETA has resulted in prices which are more reflective of underlying generation costs. Coalpro therefore supports the introduction of BETTA and believes that it will result in a further lowering of prices and a further increase in coal consumption, particularly at the low cost Scottish coal-fired power stations.

One inadvertent impact of NETA has been the loss of some market transparency. Under the Pool arrangements aggregated generation unit by unit was available from ESIS and published in a number of journals such as Power UK, UK Powerfocus and Coal UK. Under NETA this is no longer available and proposals to modify the Balancing and Settlement Code to permit the production and release of this data has met with a negative response from the industry. Modification Proposal P50 sought to redress the situation but the BSC Panel has recommended rejection. One of the original objectives for NETA as published by Ofgem in January 1998 was to

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“provide for transparency in the operation of the pricing mechanism and the market generally”. We believe that the publication of aggregated generation data on a weekly and/or monthly basis would enhance the transparency and help companies outside the BSC to understand developments in the market and assess the effective operation of the market. We therefore propose that revision to the BSC code to incorporate GB wide arrangements includes a requirement that the system operator produces aggregated generation data in line with Modification Proposal P50.

We are concerned over the treatment of losses and the potential for discrimination against coal fired power stations in the North of England and Scotland. We would like to be closely involved in discussions on this issue.

The Seven Year Statement published annually by NGC is a very useful document and should be produced on a GB wide basis as soon as possible.

The Ofgem/DTI paper specifically asks for comment on the next steps as set out in Section 6 and Appendix 4. Coalpro agrees with the process set out therein but believes that there are two fundamental issues that need to be addressed immediately.

First, the document does not envisage that the Scottish restructuring contracts will be brought to an end with the legislation needed to implement BETTA. These contracts were enshrined in the enabling legislation for the privatisation of the Scottish electricity industry. They are fundamentally anti-competitive. In particular, the Nuclear Energy Agreement (NEA) provides a guaranteed market for the entire output of British Energy's Scottish power stations. Consequently, if the NEA is permitted to outlast the introduction of BETTA, it will prevent the emergence of a fully competitive wholesale electricity market in Scotland. The achievements of the objectives of BETTA will therefore be significantly compromised.

Secondly, the document considers, but rejects, the need for separate ownership of the system operator function of the transmission network. The implication is that the GB wide system operator will be NGC. Coalpro has argued for separate ownership in response to previous consultations on BETTA. Ofgem argue in the paper that there may be benefits in retaining common ownership. However, whilst this may have been arguable at the time this document was being written, the announcement of the proposed merger between NGC and Lattice (Transco) fundamentally changes the position and means that common ownership of the system operator function and the transmission network assets is no longer acceptable.

Such a merged company would have a clear financial interest in maximising the flow of both gas and electricity through the respective networks. There are obvious economic incentives for the electricity system operator to so arrange the operation of the network to the advantage of gas-fired generation to maximise the flow of gas through the gas transmission network. There are obvious opportunities for anti-



competitive cross-subsidisation. This would act to the disadvantage of generators using other fuels, including coal.

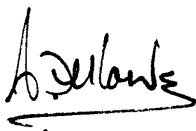
It may be argued that the operation of both networks is subject to regulatory requirements and supervision. However, the availability of information between regulators and those regulated is asymmetric, a point specifically made at para R 10 of the Draft Regulatory Impact Assessment. For this reason, Coalpro's view is that the merger should not be allowed to proceed in any event, and this point has been made in response to Ofgem's consultation on the proposed merger (my letter of 23 May to Lisa Vango refers). This applies to England and Wales, let alone in the context of BETTA.

Coalpro therefore believes that, if the merger is allowed to proceed, the opportunity should be taken in the BETTA legislation to enforce a separation of ownership of the system operator function from ownership of the assets of the electricity transmission network.

To summarise, Coalpro strongly supports the principles behind, and a rapid implementation of, BETTA. However, to achieve the objectives of BETTA requires that the enabling legislation both brings to an end the Scottish restructuring contracts, particularly the NEA, and separates the ownership of the system operator function from the rest of the transmission network. Coalpro agrees with the next steps in the process as set out in the paper, but believes that these fundamental issues should be addressed immediately.

These points have also been made to the DTI in our response to the Draft Regulatory Impact assessment and a copy of my letter to Richard Penn is attached.

Yours sincerely


B J Rostron
Director General