

By e mail to : soincentives@uk.ngrid.com

Response to System Operator Incentives Initial Consultation

We are grateful for the opportunity comment on your initial proposals for the system operator incentive mechanism for 2008/9. Our company RLtec is a UK company developing a number of products aimed at improving the efficiency of electricity supply chains around the world using dynamic demand response technology lowering carbon emissions. Our technology is now at the stage of commercialisation and we therefore have a direct interest in how system operators purchase these services, particularly when provided by new and innovative means. We aim to be providing a commercial ancillary service to NGC in 2008.

Consultation Process

We attended the workshop on 10th January and felt it was well conducted and informative. The consultation process appears to be a genuine attempt by NGC to determine what sort of incentive scheme its “customers” want and more specifically how the risks associated with the uncertainties faced should be shared between customers/suppliers and NGC.

We recognise that the aim of any incentive scheme is to share risk between NGC and those parties who pay Balancing Services Use of System Charges (which all of course end up being paid by the final customer) so as to encourage efficient behaviour by NGC so that the probability of those charges being as low as possible is maximised. There is an issue, however, as to whether in doing this NGC should concentrate on minimising the charges in the current year, or take action that would be expected to minimise balancing costs over the long term. It is to this issue that we address the substance of our response to the consultation.

Longer term investment in balancing cost reductions

Currently NGC’s statutory duty is to “develop and maintain an efficient, co-ordinated and economical system of electricity transmission.” The inclusion of the word “develop” makes it clear that there is a duty to undertake whatever development is prudent in order to increase efficiency in the future. This applies just as much to the System Operator side of the business as the Transmission Owner function.

We therefore think that the System Operator has a duty to undertake work that is expected to improve efficiency in the future as well as to operate as efficiently as possible in the current time period. The question, which you consult on in paragraphs 142 to 146 of your document is how the development of technologies that may reduce the cost of balancing the system in the future should be funded.

The first question that you ask is whether “the funding of such projects by electricity consumers is appropriate.” Funding could be taken to mean a number of different things, and our view is that this “funding” might mean:

- 1) Paying for the costs of research and development into new technologies.
- 2) The cost of capital used to buy a service where the service is paid for up front.
- 3) The additional “pump priming” cost of allowing NGC to purchase at **market price**, smaller quantities of load where such initial quantities do not necessarily displace existing contracts for large numbers of megawatts of Response and Reserve.

- 4) The cost of NGC implementing systems and processes to facilitate implementation of contracts with new technology providers.

We do not believe under any circumstances it is appropriate for item 1 to be funded by energy consumers through BSUoS and in the case of item 2 this would be appropriate only if the service was economic. With regard to item 4 this cost should be included in the assessment as to whether a technology is economic.

However we strongly feel item 3 is appropriate as this will allow NGC to introduce new, innovative and carbon reducing technologies to the balancing system even if at first existing contracts are not displaced.

Regulatory issues

Once a service can be offered that is “economic”, it is entirely appropriate that it be funded by the current year’s BSUoS charges. Some technologies once installed are effectively set up to provide the service for a number of years; i.e. cannot be purchased on a year by year basis. However there is a possibility that, when reviewed at a time in the future, they may not then currently appear economic.

Clearly predicting whether a service will be economic over a multi-year period carries a higher risk than establishing what it is economic over a shorter period. In our view NGC should be able to purchase services for many years into the future, as doing so would encourage innovative solutions to the market. This is a matter to be discussed between NGC and Ofgem but we think that the guiding principle should be that where the service is economic at the start of the period it can reasonably be expected to remain economic throughout the required delivery period.

Thus in summary we feel that:

1. Pure research and development costs of a new technology should **NOT** be funded by energy consumers through BSUoS.
2. Costs of new economic technology service provision, however, **should** be funded by BSUoS, just like any other service provision, even if **initially** it does not displace existing contracts.
3. In addition, where a contract is signed covering the provision of a service for several years, which on signing appears to be economic, but at some time in the future ceases to be economic, due to unforeseen changes in circumstances, the charges **should continue** to be recoverable from BSUoS charges.

We hope that you find these comments useful. Please let us know if you would like to discuss them further. We are copying this response to Ofgem for information.

Yours sincerely,

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