

Malcolm Arthur & David Smith
National Grid Electricity Transmission plc
National Grid House
Warwick Technology Park
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Dear Malcolm and David,

EDF Energy is pleased to respond to the initial proposals of the 2009/10 SO incentive scheme. We also thank you for presenting your proposals in person to our company.

EDF Energy prefers capital investment in the system rather than increased operational expenditure through BSUoS. With capital investment there is a tangible asset that can provide continued benefit, whereas unwarranted operational expenditure is often related to regulatory or planning failure. An example is the cost of constraints across the Scotland-England circuits upon BETTA, where costs were largely ignored in introducing a GB market. These constraint costs have been a feature of all SO schemes since 2005-06 and will continue until the circuits are compliant with planning standards.

It is clear the disparity between a 5-year transmission price control and a single year SO incentive scheme, coupled with the light regulatory oversight on alleged abuse of Scottish system constraints has resulted in unmanageable costs and significant competitive distortions.

Key points from our response are:

- The bid-offer prices used to budget a constraint appear to involve a tacit acceptance of relevant generators continuing their past/present tactics. We note the Scottish bid premium and would hope Grid would work with the regulator to help analyse and resolve the problem of generators allegedly abusing constraints in Scotland;
- An assumption that the Scottish bid premium will continue may be erroneous, given the formal Ofgem investigation into alleged market abuse by two Scottish generators;
- The costs for the new inter-connector UIOLI regulation is a provision: this creates an unfair expectation that these costs would be incurred, rather we would prefer the use of an IAE after the event;
- Market length – we want to see the inclusion of part-loaded units in the assessment of free headroom for resolving imbalance, frequency response and constraints. It appears that part-loaded units are only incorporated when calculating operating reserve costs;
- The costs of Operating reserve, Response BOA costs and constraints appear to be valued independently of each other, yet in practice may be resolved concurrently. We wish for this to be explained further in the final proposals.

Overall we would believe the scheme should be:

- Far lower than 2008/09 costs, therefore **these initial proposals are far too high**;
- New NIA: because it more accurately reflects costs of resolving imbalance;
- Option 1 : with no cap or collar as it reflects the asymmetric profile of costs;

- Reactive power should be split out of the scheme and targeted over more than one year;
- Transmission losses should not be unbundled.

Yours sincerely, Paul Mott, Electricity Regulation Advisor

Question 1 – Do you agree with the areas identified as the main cost drivers for 2008/09? Are there any other drivers not explicitly identified ?

Yes, we agree with the main cost drivers, although we would wish for free headroom to be included in addition to the headroom provided through a long market – this is not included in the figure 2.4, which shows the relationship between NIV and costs. For instance there may be a short market with many part loaded units that may be cheaper than a long market with few part-loaded units.

Question 2– Do you agree with the high level assumptions outlined:

- Utilisation of forward power prices and the 60% - 160% range?
- Market length central ranges?
- Generation availability and utilisation of OC2 data?

Yes. Although as per above we request inclusion of part-loaded units' headroom. Also we'd expect in the final proposals (put to Ofgem) the NIV forecast to incorporate the longer months of October – December 2008.

Question 3– Do you agree with the assumptions (described in detail in the appendix) used to forecast the various elements that make up underlying balancing costs?

No. The assumption that Scottish constraint prices will remain with a significant bid premium may be erroneous given that there is a formal Ofgem investigation nearing completion (into alleged market abuse of the Scottish companies).

Market length - we want to see the inclusion of part-loaded units in the assessment of free headroom for resolving imbalance, frequency response and constraints. It appears largely that part-loaded units are only incorporated into the calculation of operating reserve costs.

Question 4 - Do you agree with the areas identified as the main cost drivers for 2009/10? Please explain your rationale. Are there any other drivers not explicitly identified? In particular, do you agree with the assumptions used to forecast margin (reserve, STOR and BM start up) and constraint costs?

Not entirely. The costs of Operating reserve, Response BOA costs and constraints appear to be valued independently of each other; i.e. the Operating reserve cost is the out-of-the money costs (of the BM actions over and above the energy reference price) for the given amount of reserve required. This is also the case for BOA response costs and constraint actions, where the volume is multiplied by the price of BM actions required over and above market length (and possibly part-loaded units..?). Yet in many instances the resolution of constraints, operating reserve or response is through a single pair of BOAs. The line-by-line accounting for each of these costs gives an impression that there may some be double counting of costs such as response BOAs and operating reserve.

Question 5 – Do you have any comments on the assumptions used in determining the increase in costs associated with the revised operation of the England / France interconnector known as Use it or lose it.

The costs for the new inter-connector UIOLI regulation is a provision: this creates an unfair expectation that these costs would be incurred, rather we would prefer the use of an IAE after the event.

Question 6 - Do you believe that we should include some provision for a volume of additional generation connecting as a result of the interim connect and manage arrangements? If not, how do you believe we should manage the risk of additional generation connecting?

We quote NGET itself¹ in that Interim Connect & Manage will only add a further ~£10m to constraint costs for 450MW of capacity and in any case not immediately in time for it to increase costs in 2009-10.

Question 7 – Do you agree with the implementation of a new adjustment as described as New NIA? If not, please outline your rationale.

Yes. We agree with the philosophy behind the new NIA; the old NIA seemed to over-reward the GBSO under short conditions, yet under-reward it under long conditions – we believe the new NIA is a reasonable proposal. We would have preferred the NIA to be representative of the cost of resolving imbalance with a “perfect” transmission system such that only the most effective bids and offers are accepted. We proposed a NIA based on an Ex-post unconstrained schedule during the review of 2007 as the difference between imbalance costs and the EPUS-NIA would be an indicator of the inefficiency in the transmission system.

Question 8 – Do you agree with the implementation of a new reactive power index? If not, please outline your rationale. Are there any other indices that we should consider?

EDF Energy considers the reactive power index is appropriate and should be accompanied by separating reactive costs from the annual bundled scheme, to be targeted over a number of years. This should allow you to make investments that pay off over a longer period.

Question 9 – Do you have any comments on the forecast range of incentivised balancing costs for 2009/10? Specifically do you believe that the range is too wide or narrow or do you believe it represents a full range of costs?

The range, ignoring level, may not be unreasonable in representing the uncertainty in forecasting costs but we believe, considering the increases we have seen in BSUoS over the last few years; the forecast itself (disregarding the range) is significantly too high. The increasing pressures being placed on the transmission system, LCPD, wind, outages, circuit derogations, etc will only serve to increase this uncertainty and range in costs. It must be remembered that the massive increase in costs has been through various causes including the deficient Scottish transmission system under NETA.

Question 10 – Do you have any comments on option 1? In particular:

- sharing profile
- benefits / drawbacks of such a scheme
- do you support implementation of such a scheme in April 2009?

EDF Energy supports the proposed approach outlined in options 1. It makes sense to create an incentive scheme that encourages NGET to reduce costs when it would normally have exceeded a cap or collar. It also reflects to some extent the asymmetric nature of the risks associated with system operation.

Question 11 – Should we consider a change to the incentive period to ensure that an incentive remains on National Grid over the year? Would you support the implementation of such a scheme?

We do not support a monthly incentive; we have a preference for Option1.

Question 12 – What could such an incentive scheme look like?

- incentive period (e.g. monthly, quarterly)
- caps and collars
- sharing factors

N/A

Question 13 – Do you agree with the implementation of reactive power indexation?
Yes

¹ NGET User Seminar December 2008

Question 14 – Do you agree with the unbundling of reactive power? Should the bundled scheme caps and collars be changed from 20m?

Yes and yes.

Question 15 – Do you agree with the unbundling of transmission losses? Please give your rationale.

No; as NETA is self dispatch so transmission losses are not directly under the control of the system operator.

Question 16 – The transmission losses reference price is currently calculated on an annual basis. Do you believe there are any benefits in changing this to a more frequently calculated transmission losses reference price, such as daily? Please give your rationale.

Yes, as this should be more cost reflective.

Question 17 – Are there any other components that you believe should be unbundled?

No. In the SO incentive review of 2007 EDF Energy championed both price and volume (market length) indexation for the scheme rather than unbundling of components.

Question 18 – Do you agree with a multi-year reactive power scheme? Please give your rationale.

Yes. Such a scheme will allow NGET to invest in measures that reduce costs over a longer period.

Question 19 – Do you agree with the implementation of a multi-year Transmission losses scheme? Please give your rationale. Are there any other components that you believe should have a multi year scheme?

No. We do not agree with a multi-year scheme for transmission losses as: 1. The GBSO cannot influence the level of losses significantly as it does not dispatch plant under NETA and; 2. Transmission losses modification P229 may change the regulatory allocation of losses, thus ruining the intention of the scheme.

Question 20 – Are there any other components that you believe should have a multi-year scheme?

No

Question 21 – Which is (are) you preferred incentive scheme (s)? Please provide reasons and your views on caps, collars and sharing factors.

Option 1. It reflects the asymmetric risks presented by NGET of the costs in running the system, which appear reasonable if you consider the difficulties in assessing the costs of recent schemes. Also, EDF Energy would wish for a scheme to have no cap or collar.

Question 22 – Do you have any comments on the forecast range on BSUoS costs for 2009/10

EDF Energy is astounded that the cost of the TIRG works (£560m in infrastructure) will be eclipsed by the ongoing £200+ p.a. costs of managing constraints in Scotland. These costs are unacceptable, especially as the forecast for constraints in Scotland includes a “bid-premium” to allow for the lack of competition in the balancing mechanism north of the constraint boundary. The Scottish generators are profiting from these arrangements, through Balancing mechanism instructions, Intertrip payments and constraint contract payments. We implore you to look to publish more information on the costs of constraints and especially the “out-of-the-money” prices that you are forced to accept from Scottish generators.

Question 23 – Did you find the level of information within this consultation, and associated documentation and workshop, on our balancing and BSUoS costs forecasts for the current year and 2008/09 informative? What additional information should National Grid provide to explain better the costs and cost drivers?

We were satisfied with the information provided in the consultation and would like to thank you for running it. One area of analysis that we would like to see investigated is the total volume of free headroom provided by either part-loaded units or through market length. The analysis focuses principally on market length and its relation to cost rather than market length AND part-loaded units' free headroom.

Question 24 – Do you have any further comments on the analysis and information provided within the appendices to this consultation or in the further documentation available on our website?

Question 25 – Do you have any further comments on any aspect of this consultation in relation to the Electricity SO?