



Malcolm Arthur
National Grid
National Grid House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA

E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
CV4 8LG
eon-uk.com

Paul Jones
024 76 183 383

paul.jones@eon-uk.com

18 September, 2009

Dear Malcolm,

**National Grid Electricity Transmission System Operator Incentives for 1 April 2010
(Mini Consultation 2)**

Thank you for the opportunity to respond to the above mini consultation. This response is made on behalf of E.ON UK plc.

We are concerned that the formulation of the Balancing Services Incentive Scheme is in danger of becoming more complicated and fragmented. The BSIS scheme is important in that it provides a focus on National Grid to ensure that balancing costs are managed efficiently as required under its licence. However, we have always maintained that the incentives required to achieve this do not have to be overly onerous. The company can be incentivised by a relatively modest cost sharing arrangement, particularly as many of the initiatives National Grid undertakes are of an operational nature rather than being particularly capital intensive.

One of the important considerations in setting the scheme is the amount of interactions between various elements that make up Balancing Services. Past discussions regarding cash out prices show for example that there is an interaction between the actions taken for constraint purposes and those taken for energy balancing. Often it can be shown that actions are taken for both purposes. More fundamentally, however, it is clear that it is not possible to define precisely what is energy and system balancing.

E.ON UK plc
Registered in
England and Wales
No 2366970
Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

Therefore, given the interactions between different elements of balancing costs and the difficulty to allocate certain actions to each category, we believe that any unbundling of costs should be kept to a minimum. Therefore, we are supportive of maintaining a bundled scheme.

Additionally, as with responses to other consultations on BSIS, a longer than one year scheme still holds a concern for us as it would make the raising of income adjusting events more likely. IAEs are a significant risk for BSUoS payers in that they occur after the end of the charging year to which they refer and consequently represent cost shocks to participants which are extremely difficult to manage in the competitive market. A longer scheme makes it more likely that future issues will arise that have not been taken into account when setting the incentive arrangements. Therefore, the possibility of IAEs increases.

Nevertheless, it is correct that an adjustment such as the Net Imbalance Adjustment should be made to the BSI Scheme to ensure that the costs of energy balancing which are not fully in National Grid's control do not overly influence the operation of the incentive. However, the sophistication of this a mechanism should be proportionate to what it is trying to, or is able to, achieve.

It is clear that a large amount of analysis has been undertaken to try to achieve a best fit line to the data from April 2005. Whilst a good regression fit has been achieved from a fairly complex defined relationship for the four years of data, we are not convinced that this level of correlation can be assumed to hold for following years. Therefore, there is danger that we are seeking too high a level of accuracy from the NIA term which in reality is not achievable.

There is also definitely a trade off to be made with the simplicity, or transparency, of the arrangements. High levels of complexity and unbundling makes it more difficult for participants to understand and monitor the operation of the scheme. A major issue for suppliers in particular is to understand what this means in terms of expected BSUOS costs so that these can be factored into prices and tariffs quoted to customers. The more uncertainty there is associated with these costs, the higher a risk premium is required to manage them on behalf of customers. Some of the proposed NIA equations derived appear overly complex and would seem to be a disproportionate response.

Therefore, we believe that the scheme should remain as bundled, for one year and that the NIA should not be made overly complex.

Yours sincerely

Paul Jones
Trading Arrangements