

Potential Enhanced Electricity Transmission Owner (TO) Incentives: Follow-Up Note

National Grid, May 2010

1. Introduction

On 18th September 2009, National Grid published an informal consultation¹ to the industry, entitled Potential Enhanced Electricity Transmission Owner (TO) Incentives. The purpose of the document was to consult the industry about whether there were benefits in pursuing potential approaches to enhance:

- the timely connections to the transmission networks, particularly in the context of the current 'Interim Connect and Manage' regime and;
- TO measures to contribute to the minimisation of network constraint costs which significantly have risen in recent years.

The overall objective of the consultation was to highlight all the potential measures to enhance the role of the transmission companies within the existing SO/TO interface arrangements and to consider whether further new or revised approaches to incentivising transmission companies in relation to some key transmission activities were desirable. These developments covered a spectrum of possibilities, some of which could be taken forward in the short term and some of which could form areas for development in the longer term, which can then be built on in subsequent years.

This follow-up note provides a summary of the responses to the consultation and provides an update on the work that is being progressed as a result.

2. Summary of Responses

Seven responses were received in reply to the consultation. A high-level summary of the consultation chapters and the responses received to the questions asked is presented below.

2.1. Chapter 3, "Investment Incentives for Grid Connections"

This chapter proposed an enhanced investment incentive in England and Wales to complete local connection works in faster than normal timescales. No compelling need for further incentivisation in Scotland was identified, as incentives already exist regarding completion of local works for Scottish Transmission Owners that were established via the last transmission price control.

2.1.1. Incentivising accelerated local works for generation connections

Some respondents suggested that changes to the England & Wales arrangements to provide an incentive to agree and complete local works in faster than normal timescales, where customers want to connect quickly, may be appropriate and desirable, but that further analysis should be undertaken to fully assess the likely impact of such changes.

¹ <http://www.nationalgrid.com/NR/rdonlyres/FB4A9925-15AB-462A-B516-33543A44B460/37082/PotentialEnhancedElectricityTransmissionOwnerIncen.pdf>

2.1.2. **National Grid's suggested UCA uplift model**

Some respondents questioned whether the implementation of a generic level of UCA uplift would be appropriate in all cases, and stated that further analysis should be undertaken in this area. Others suggested that the aims of such a scheme should already be met by current licence conditions.

A number of respondents expressed concern that further incentives on connections may skew investment priorities and divert resources away from wider system works. They expressed the importance of ensuring that incentives relating to connection works, wider works and SO constraint management activity were suitably aligned to give a more efficient overall solution.

2.2. **Chapter 4, "SO/TO Interface Issues"**

This chapter considered a number of improvements to the way the System Operator interfaces with both the Scottish and England & Wales Transmission Owners.

2.2.1. **SO-TO Outage Co-Ordination Arrangements**

There was broad support for extending the current duration of the final outage plan from one to two years to provide greater scope for outage optimisation and co-ordination between SO, TOs and generators, whilst also allowing change costs to be funded over this extended period. However, such support was not unqualified:

- A number of respondents expressed concern regarding taking a piecemeal approach to specific targeted incentives, mentioning instead the need to ensure a co-ordinated and efficient overall incentive structure for SO and TO activities; and
- Some respondents were keen to avoid the introduction of a perverse incentive to develop a sub-optimal initial outage plan.

A number of respondents noted that the ability to manage outage changes depends to a certain extent on the availability of resource. One respondent in particular noted that the outage change allowance mechanism does not currently allow for forward planning (due to resource scarcity), and noted that longer notice and a robust mechanism for funding such resource would help in this regard.

2.2.2. **Current SO Incentivisation of STO Outage Change Allowance**

It was widely acknowledged amongst respondents that the structure of the SO incentive for managing the STO outage change allowance, with its cost pass-through structure outside the incentivised range, appears ineffective; and there was widespread support for a fundamental review of its structure.

2.2.3. **SO/TO Interaction in England and Wales**

There was broad support for addressing, in the short term, those differences between the SO and TO incentives that could give rise to perverse incentives.

Respondents were of the view that aligning the incentive structures should promote a more optimal approach to managing constraints across both SO and TO activities.

Some respondents reiterated the need for a co-ordinated approach to SO and TO incentives in the longer term, and expressed concern regarding the use of an outage change allowance in England and Wales – one in particular noting that an analysis of the potential costs and benefits of using such a mechanism should be considered alongside changes to the STO outage change allowance.

2.2.4. SO Driven Capital Expenditure by Scottish TOs

There was support from the Scottish TOs for a ring fenced capital expenditure allowance that could be used for SO driven projects, and drawn down on a case by case basis, although it was noted that such work should not compromise essential reinforcement projects.

There was less support from E&W respondents, with most suggesting that further justification and cost-benefit analysis would be required. One respondent suggested instead that TOs should be exposed to the cost of system operation related to constraints, and that incentives should be placed on them to avoid constraint-related system operation.

2.3. Chapter 5, “Aligning TO and SO Incentives to minimise Constraint Costs”

This chapter considered, at a high level, three ways of incentivising TOs to help manage constraint costs. One respondent provided comments relating to each specific option, with other respondents providing more general comments.

2.3.1. Incentivising specific outage change activity

The respondent suggested that, in view of the urgent need to improve constraint incentives in the short term, a direct incentive might be considered for April 2010. However they considered that, if a percentage uplift on the STOs’ recovery of reasonably incurred outage change costs were to be used, then the level of uplift should be subject to robust justification.

2.3.2. Incentivising the availability of transmission capacity

The respondent suggested that existing TO incentives might be enhanced with a time-based incentive to minimise constraint volumes on derogated transmission boundaries only – this being a variation on the proposed option, which proposed an incentive to maintain transmission capacity on all boundaries or circuits.

The respondent noted that this could be developed to provide an incentive on TOs to lift derogations more quickly than planned; could complement a TO incentive on local connections and might be beneficial under a Connect and Manage regime for transmission access, with time-limited boundary derogations from the NETS SQSS.

2.3.3. **Incentivising minimisation of network constraints**

The respondent noted that this option involves a significant amount of complexity and would need considerably more consideration, assessment and development.

2.3.4. **General Comments**

Other respondents were in agreement that developments in this area would be complex and require detailed consideration, precluding implementation in the shorter term, with a preference for any such incentives to be introduced at the start of a new price control period.

Some respondents were wary of creating incentives that reward licensees simply for meeting the terms of their licence, and possibly to the detriment of their normal baseline performance.

3. **Post-Consultation Activities**

National Grid has held a number of discussions with the Scottish TOs to consider the responses to the consultation and discuss and agree the next steps in the development of the SO/TO interface.

The key themes being discussed are around developments to the outage planning and investment planning processes with a view to enhancing the co-ordination and optimisation of outages.

3.1. **Outage planning process**

Potential developments to the outage planning process are focusing on improving the ability to work together to optimise load and non-load related outages, with the aim of minimising overall outage costs. Work is underway to consider in more detail how this might be achieved, for example by extending the duration of the Final Outage Plan from one to two years, and to investigate what the impact on SO and TO resource, and the increased information provision requirements is likely to be.

3.2. **Investment planning process**

Potential developments to the investment planning process are focusing on improving the ability to work together to deliver investment schemes, for example by enabling SO involvement earlier in the process, again with the aim of minimising overall outage costs. Work is underway to consider in more detail how this might be achieved, for example by enabling the SO viewpoint to be put forward and taken account of where appropriate.

4. **Next Steps**

Changes to the outage and investment planning processes resulting from the ongoing work are expected to require changes to be made to the SO-TO Code. Once the work is sufficiently advanced, these changes will be raised in accordance with STC governance processes.

In line with the consultation responses, a number of areas of work are expected to be considered as part of the next transmission price control

review. Through their RPI-X@20 process², Ofgem has already highlighted the potential for changes to the regulatory framework to encourage transmission owners to make more efficient trade-offs between capacity management and network investment, via the alignment of SO and TO incentives.

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<http://www.ofgem.gov.uk/Networks/rpix20/publications/CD/Documents1/et%20long%20term.pdf>