



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

21 October, 2009

Dear Malcolm,

Potential Enhanced Electricity Transmission Owner (TO) Incentives

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

Incentivising Timely Grid Connection

We as a developer of new power projects are very keen on ensuring that Transmission Owners (TO) develop our connections to the transmission system in a timely manner in accordance with our requested or agreed connection date. Therefore, an initial impression would be that anything that incentivises this is a good thing. However, we believe that this should already be current practice by the TOs in order to meet the terms of their licence. We accept that, as with the Balancing Services Incentive Scheme, specific financial incentives can provide an additional motivation to licensees to do this. However, there is also a legitimate concern that they could merely provide additional revenue to companies in return for achieving the same level of performance that would have occurred anyway. In developing such an incentive it would be important to consider how to define the level of baseline performance against which a potential accelerated connection would be measured.

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

Our main consideration is that the date that we have requested is achievable or alternatively that an agreeable alternative date that is suitably close to that requested is offered. If a developer wants to accelerate a connection programme, at present it faces additional one off charges for the additional work required to do so. Clearly, it would be attractive to developers if an incentive arrangement were in place instead to provide the incentive as these deep one off charges could be avoided. However, there is a concern for wider charge payers that this will result in higher costs for all users for little benefit.

Additionally, should an incentive be put in place to accelerate local connections, it would be difficult for developers to know whether a request to have a connection date brought forward would be covered by the incentive scheme or be classed as a “customer choice” request covered by deep one off charges. If there was to be such a two tier arrangement it would also be important to show how connections were being attributed to each category (ie whether to be covered by the incentive or funded by the requesting developer) on a non discriminatory basis. This is of particular importance in Scotland where the TOs have associated generation interests and will need to be seen as acting impartially. Indeed, generally where only a finite number of schemes are able to be brought forward, it would be important to ensure that successful schemes are chosen on a non discriminatory basis.

The document asks for views on the extent to which developers would be interested in bringing forward connection dates for local works. Whilst there is likely to be some demand for this, it is not possible to state at the moment the extent of that demand. However, as a proxy the dates that have been requested by developers in their applications and which have not been met in subsequent offers could be an indication of this.

If an incentive scheme is implemented, it will also be important to ensure that this does not over incentivise TOs to focus on building local connections at the expense of wider system reinforcements. Clearly, for developers utilising the connect and manage arrangements ensuring that local works are built will be the priority. However, for developers with connections contingent on wider works and for wider balancing cost payers, the timely completion of wider works is equally if not more important.

On balance, we believe that specific financial incentives for TOs to provide timely connections are unnecessary and would potentially cause more problems than benefits.

SO/TO Interface Issues and Aligning SO/TO Incentives

We would be concerned if there is not presently a belief within transmission licensees that they are required under the terms of their licences to minimise the combined cost of building and operating the transmission system. Clearly, specific financial incentives presently operate such as the Balancing Services Incentive Scheme. However, they should be seen as facilitating the over arching licence requirements and not as defining their limits. Therefore, if transmission owners have formal financial incentives only to minimise capital and operational expenditure, it should not be assumed that this can be achieved at the expense of balancing costs.

We would be wary of creating incentives which reward licensees simply for meeting the terms of their licences. Indeed, when specific financial rewards are introduced there is a concern that normal baseline performance could deteriorate specifically to provide more opportunity to earn money under the incentive scheme. For example, outages may not be planned as efficiently leaving more scope for “savings” to be achieved by rescheduling under outage change allowances. However, we do agree that the design of the present outage change allowance appears somewhat perverse when benefits and costs are not capped or collared, but are entirely removed outside of the active range of the scheme.

We are concerned that the solutions that have been proposed appear to be piecemeal in nature aimed at specific cost elements, where an overall incentive to minimise the aggregate cost of operational, capital and balancing costs may be what is needed. As we have mentioned in our responses to BSIS consultations, we believe that where there are interactions between different cost elements, unbundled schemes may prevent tradeoffs from being considered efficiently.

This is especially true where there are differences in the sharing factors associated with each element of the trade off. This does not have to mean explicitly different sharing factors for each class of cost. For instance, each may have the same upside factors and the same downside factors. However, if there is asymmetry between the two factors perverse incentives can be created by each scheme operating on different percentages.

For example, imagine that £15m in one scheme can be saved for a £10m expenditure covered by another scheme. If the scheme under which the saving of £15m is being made is on a 15% sharing factor then a profit of £2.25m would be seen by the SO. If the cost of £10m is made against a 25% sharing factor then a loss under that scheme of £2.5m would be experienced by the SO. The net result would be a loss of £0.25m which would not be an incentive to do the efficient thing to achieve the possible £5m saving.

Therefore, in summary we believe that the transmission licensees should already be focussed on minimising costs in general in order to meet the terms of their licences. We perceive a number of problems with extending the formal financial incentives that the transmission companies face, so at present we do not believe that any new incentives should be introduced. However, there does appear to be some benefit in removing perverse incentives in existing schemes and the example of the present outage change allowance appears to be a case in point.

Yours sincerely,

Paul Jones
Trading Arrangements