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8<sup>th</sup> January 2009

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## **National Grid Electricity System Operator Incentives – Initial Proposals Consultation**

### **Commercial – In Confidence**

Dear SO Incentives

Thank you for the opportunity to comment on the on the National Grid Electricity System Operator Incentives – Initial Proposals Consultation. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply and Trading GmbH and RWE Innogy.

We welcome National Grid's open and transparent approach towards the setting of the parameters for the 2009/10 system operator incentives scheme. However, as we have noted previously we believe that we do not have sufficient information to comment fully of the details of the assumptions used by National Grid since they relate to commercially sensitive information or more specifically to information required to operate the transmission system.

While we support an incentive-based approach towards system operation we do not believe that development of the current scheme is the most appropriate way forward. Our preference is to develop a performance-based approach that relates to specific areas of controllable costs where National Grid should have relevant incentives to influence outcomes. Such an approach would help to reduce any windfall gains or losses that may arise from external events such as the rapid increase and subsequent decrease in the price of electricity. A performance based scheme should provide National Grid with sufficient returns to provide incentives to innovate and deliver enhanced levels of service for the benefit of all users and customers.

Our response to the specific questions is included in the enclosed Attachment. If you wish to discuss any aspect of our response, please do not hesitate to contact me.

Yours sincerely  
*By email*

Bill Reed, Market Development Manager

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## **Attachment 1: Response to the Specific Questions**

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

The recent volatility in the electricity market demonstrates that the key driver of the 2009/10 SO incentive scheme will be the price of electricity, itself influenced by the price of fossil fuels (oil gas and coal). The recent volatility in prices makes predictions more difficult, but the assumptions made by National Grid appear reasonable, subject to revisions that reflect the recent falls in electricity prices.

**2 Do you agree with the high level assumptions outlined:**

- utilisation of forward power prices and the 60% - 160% range?
- market length central and ranges?
- generation availability and utilisation of OC2 data?

We see no reason to question the validity of the assumptions made by National Grid.

**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?**

We see no reason to question the validity of the assumptions made by National Grid.

**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?**

We agree that National Grid have identified the main cost drivers for 2009/10.

**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?**

No comments

**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 are uncertain as to the extent to which interim connect and manage will require additional generation. Therefore we do not believe any specific provision should be required.

**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 new adjustment.

**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?**

We question the basis for establishing the incentive arrangements for reactive power since external events (e.g. power flows) seem to have more influence than the intervention by National Grid. We believe that this is a good example where performance based incentives may work better.

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

No comment

**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**

While option 1 may better reflect the risk profile this is at the expense of making the arrangements more complicated and less transparent to the market.

**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 an incentive?**

Since the scheme is established as an annual scheme we believe that the incentives should remain on National Grid throughout the year.

**12 What could such an incentive scheme look like?**

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

See answer to question 11

**13 Do you agree with the implementation of reactive power indexation?**

See answer to question 8

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

We believe that the reactive power incentive should remain in the bundled scheme at this time or until there is sufficient justification for a separate scheme.

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

We believe that the transmission losses scheme should remain in the bundled scheme at this time or until there is sufficient justification for a separate scheme.

**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.**

We see no basis for any change to the current approach towards the transmission losses reference price.

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

No

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

No – we support the development of a performance-based approach towards incentives.

**19 Do you agree with multi-year transmission losses scheme? Please give your rationale.**

No – we support the development of a performance-based approach towards incentives.

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

No – we support the development of a performance-based approach towards incentives

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

We support the development of a performance-based approach towards incentives (see covering letter).

**22 Do you have any comments on the forecast range of BSUoS costs for 2009/10?**

No

**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 believe that the incentive scheme consultation should be supported by evidence that National Grid in performing its role has influenced the out turn costs. This would indicate that the incentive scheme is delivering value for money for all users and customers. In addition, National Grid should provide an indication of its plans to influence outturn system operation costs in 2009/10.

**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?**

No

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

No