

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

Name Bill Reed  
Phone 01793 893835  
E-Mail [bill.reed@rwe.com](mailto:bill.reed@rwe.com)

3<sup>rd</sup> October 2008

Email: [soincentives@uk.ngrid.com](mailto:soincentives@uk.ngrid.com)

**National Grid System Operator Incentives: Consultation on the Development of an Incentive Target Indexation Methodology**

Dear Malcolm

Thank you for the opportunity to comment on the Consultation on the Development of an Incentive Target Indexation Methodology. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply and Trading GmbH and RWE Innogy.

In principle we support changes to the SO incentive scheme which improve the predictability and reliability of the forecasts that underpin such a scheme and consequently benefit the industry in terms of the predictability of outturn costs. However, we are unconvinced that indexation alone will result in a significant improvement from the industry perspective. In particular, while indexation can help the SO to manage the risks associated with the volatility of power prices in terms of the scheme outcomes, it does not address any of the wider issues for the industry as a whole. Consequently, we believe that indexation while helpful to the SO in managing its costs is a relatively minor change in the context in the wider volatility of SO incentive scheme costs.

Our response to the specific questions raised on the consultation is included enclosed as an attachment to this letter.

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

RWE Trading GmbH  
Swindon Branch

Windmill Hill Business  
Park  
Whitehill Way  
Swindon SN5 6PB  
United Kingdom

T +44(0)1793/87 77 77  
F +44(0)1793/89 25 25  
I [www.rwe.com](http://www.rwe.com)

Registered No. BR 7373

VAT Registration No.  
GB 524 921354

Advisory Board:  
Dr. Ulrich Jobs

Management:  
Peter Terium (CEO)  
Dr. Bernhard Günther  
Stefan Judisch  
Dr Peter Kreuzberg

Head Office:  
Essen, Germany  
Registered at:  
Local District Court,  
Essen

## **Attachment 1: Response to the Specific Questions Raised in the Consultation Document**

### **1 Do you agree with the principle of indexation?**

*Answer - Indexation as proposed in the consultation may assist the SO in managing the risks from an SO perspective when compared with full exposure to the volatility of power prices. However, we do not believe that indexation in its own right will address wider industry concerns about volatility of incentive scheme costs.*

### **2 Do you support the use of indexes for the scheme starting in April 2009?**

*Answer – If indexation is to be implemented then we would support its introduction from April 2009.*

### **3 What incentive components should be included in the indexation methodology?**

*Answer - If indexation is introduced then those costs that are directly related to the components of the index should be included. In this context it is essentially the energy, frequency and reserve components of the incentive scheme that should be subject to any power price related index.*

### **4 Question 4 – Considering the volatility of the index and the individual components, are there any periods that should be excluded from the development of indexation components e.g. exclude the data from 2005/6 due to the market being unsettled in the first year of BETTA?**

*Answer – It is difficult to identify a representative period for the purpose of indexation. We believe that the sample size should be as large as possible and a suitable time series from BETTA go live would capture different conditions on the GB transmission system.*

### **5 Do you agree with the proposed method of indexing balancing costs?**

*Answer – Yes: The proposal appears to provide a reasonable correlation between power price and the variable elements under consideration.*

### **6 Are there any additional benefits / drawbacks of implementing the proposed indexation?**

*Answer – We believe that the proposal relates specifically to the costs/benefits attributed to the industry from the SO gains or losses in the SO incentive scheme. Indexation may improve the predictability of such costs/benefits for the SO.*

### **7 Do you have any comments on the development and implementation of an energy indexation?**

*Answer - No*

### **8 Do you have any comments on the development and implementation of reserve indexation?**

*Answer - No*

### **9 Do you have any comments on the development of constraint cost indexation? What incentive arrangements should be considered for constraint costs?**

*Answer – We do not support the development of constraint cost indexation. We believe that constraint costs will vary depending on the nature of the constraint and that specific measures may be required to resolve constraints (e.g. intertrips). Consequently constraint costs may not be directly correlated to power prices in all circumstances.*

**10 Do you believe that a reactive power index should be developed? What is your preferred option for a reactive power index?**

*Answer – Any reactive power index should be based on the current costs drivers, namely power price and RPI.*

**11 Do you believe that a frequency response index should be developed? What is your preferred option for a frequency response power index?**

*Answer – We do not support the creation of a frequency response index at this time.*

**12 Do you have any comments on the benefits and drawbacks of unbundling? If any, what incentive components could and should be unbundled?**

*Answer – No further comments*

**13 Are there any other forms of indexation that you believe should be further considered further?**

*Answer – No.*

**14 Do you believe that there are benefits in developing longer term incentives? Are there any benefits or drawbacks not covered by this consultation?**

*Answer – We do see some merits in developing an appropriate performance based long term incentive scheme for both the SO in relation to operating the system and the TOs in relation to transmission investment.*

**15 Did you find the level of information within this consultation informative? What additional information should National Grid provide to explain better?**

*Answer – We were satisfied with the information provided in the consultation and have no further comments.*