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Dear Lesley,

Derogations to facilitate earlier connection of generation – proposed interim approach

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

Whilst E.ON is supportive of ideas that allow generators to connect ahead of wider system reinforcements being completed, we believe that this must be accompanied by appropriate cost targeting. You will know from previous responses that we are supportive of the implementation of the alternative solution to CAP164 - Connect and Manage. This solution allows for earlier access for new generation projects than would normally be facilitated under the SQSS, but ensures that any additional costs caused by not meeting the SQSS are allocated to the generators concerned. This ensures that these generators make the appropriate economic decisions based on the full set of cost and benefit signals thereby maximising the benefit to customers.

We understand that Ofgem is concerned about this approach as it could be seen to treat new and existing generators differently. However, we believe that this concern is perhaps misplaced. The present regime simply requires generators connecting to the system to wait until certain conditions, such as the completion of network reinforcements, are met before full access rights are provided. The requirement for preconditions to be met before a contract comes into full effect is very common. CAP164 essentially allows a generator to receive the full effects of the contract concerned, the bilateral connection agreement,

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before all of the preconditions are met. However, if a party wishes to bypass these preconditions and still receive the same full contractual entitlement, it is not inappropriate for that party to be exposed to the additional costs of doing so. This is the same principle as adopted by National Grid for one off costs that are charged to generators if they wish to progress the building of connection assets in accelerated timescales.

There also appears to be a concern within Ofgem that generators can only expect to have enduring access rights for any period over which they are willing to commit to paying transmission charges in advance. The implication appears to be that the concept of a rolling right to a product is fundamentally flawed in a commercial or legal sense. We do not share such a perception as again such rights are relatively common in a variety of contractual situations. Indeed, the majority of customer agreements with energy suppliers allow precisely the same sort of rolling right, in this instance to continue to be supplied indefinitely, but also with the ability to switch at short notice.

We do not believe the current arrangements are generally discriminatory. Every generator is currently subject to the same set of commercial arrangements. The exact requirements in force at any point in time may change as the status of a generator alters, for example from when it is in the pre commissioning stage of its project to when it commissions. However, all generators on the same stage of their contractual journey are presently treated the same.

There is an important exception however and this is in respect of those generators who met the deadline set at BETTA which allowed their connection applications to be considered on a preferential basis to those who applied thereafter. We agree with Ofgem that the arrangements unduly discriminate in favour of this class of generator. Indeed, we voiced our concerns over setting of the BETTA deadline when it was proposed in 2004. However, our main concern was that balancing costs would be increased and that these would be smeared across all participants. Therefore, although we accept and agree that the deadline created a discrimination issue, it also created a balancing cost increase issue and a cross subsidy issue which together are far more important to resolve. Without appropriate cost targeting Ofgem's proposals will exacerbate these two issues rather than alleviate them.

By far the most appropriate approach is to target the costs at those who cause them to be incurred. Therefore, the balancing costs incurred over and above those that would have been on a compliant system should be targeted at those who made the system non compliant. This is the principle of targeted costs in CAP164.

We note that Ofgem believes that three main factors will restrict the cost implications of the additional 450MW of generation that has been identified for connection under the extension of the BETTA derogation. We believe that reliance should not be placed too heavily on these. The mitigating factors identified are:

- **Transmission access reform will change the arrangements so that constraint costs will only be impacted for a limited period of time.** This is by no means certain. It depends on the reform chosen, but even access auctions can be carried out against the background of a derogated system which means that balancing

costs could remain at similar levels.

- **The connection of renewable generation in Scotland will only give rise to higher constraint costs if they displace generation in England and Wales rather than in Scotland.** Generally, it should be expected that new generators would mostly displace English and Welsh generation capacity as this is where majority of generation capacity is located (as is most of the demand). Therefore, it would be incorrect to assume that new generation capacity in Scotland will offset local capacity alone or to any great extent. This is notwithstanding any market power issues that exist. Additionally, given that the connecting generation is unlikely to contribute to a secure system (given its intermittent nature) its very presence is likely to drive balancing costs up further, for example compared with 450MW of less intermittent plant.
- **That present initiatives undertaken by National Grid to manage the costs of balancing actions will limit the impact.** This may be true if the initiatives are effective, but it should be noted that there is some considerable doubt in the industry as to the appropriateness of some of the proposals raised to date.

We are also a little uncertain as to the status of Ofgem's derogations guidance. We note that Ofgem states in the letter that this guidance may not be pivotal in its decision on whether or not to grant derogations. If this is the case it would be helpful to know the criteria that are actually to be applied, so that industry and consumers can understand the basis on which such decisions have been taken.

Finally, we have concerns about the technical nature of the SQSSs being overlooked in favour of commercial drivers for derogation decisions. The SQSS describes a technical standard for the development of the transmission system. Therefore, derogations away from this should be considered ensuring that the technical integrity of the system is not compromised.

In short, we believe that the BETTA derogation has already created a significant balancing costs issue that Ofgem has recognised needs to be addressed. The nature of this issue means that significant cross subsidies between parties have also been introduced. We are concerned that without appropriate cost targeting at those parties whose actions have caused the costs, by simply extending the derogation further a bad situation will be made worse.

Please call me on the above number should you wish to discuss this issue further.

Yours sincerely

Paul Jones
Trading Arrangements