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Dear Mark,

Report from the Transmission Access Reform Options Development Group

Thank you for the opportunity to respond on the above document. E.ON UK believes that it is necessary for the current transmission access arrangements to change. However, we believe that there are one or two simple alterations which can be made and would advise against large changes to fundamentally alter the whole basis of transmission access in electricity.

As we have stated in previous responses and in correspondence with National Grid, we believe that there are two main issues with the present system which need to be addressed, consent risk and third party risk. The first of these relates to the fact that applicants are presently often required to cover large sums of money prior to knowing whether or not their project has acquired the necessary planning consents. The second relates to how these sums can move around significantly and unpredictably as a result of other parties in the same cluster terminating their connection.

Some of the ARODG discussions related to these problems and we welcome the recognition of these issues in the report and Ofgem's accompanying letter. Additionally however, the issue arose as to whether the transmission companies have enough information about where new infrastructure is most likely to be required and whether the present first come first served allocation of connections is the best way of administering the GB queue.

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Issues with Final Sums

In our presentation to Ofgem's February Seminar on Electricity Incentives, we noted two main issues with the present system.

Consent Risk: As transmission infrastructure work often takes longer than the associated generation projects to complete, this means that significant FSLs can accrue prior to generators receiving consents for their projects. It is very difficult for generators to commit to these levels of FSL at such an early stage in the project. Therefore, generators are being forced to terminate their agreements and either abandon or delay their scheme. In the context of the present queue of connection applications, delay to a project means the connection date being put back by a considerable number of years.

Third Party Risk: This is the potential for a generator's exposure to FSLs to move significantly in response to other parties entering and leaving the same cluster. Again, it causes problems for generators as it is impossible to know the full level of exposure to FSL associated with a clustered connection offer.

We continue to believe these issues should be addressed. At present, new connecting parties are exposed to the full costs associated with termination, but are unable to control the level, only the trigger event. The developer concerned has no control over, and often no knowledge about, who else is in the cluster. Additionally, there is no requirement for National Grid to consult with parties or seek their approval when they are about to undertake an element of work which will significantly increase the level of their FSLs. We therefore believe that it is reasonable that part of the risk should be shared. However, as a major payer of transmission charges, we believe that the connecting party should bear a reasonable proportion of the risk to ensure that only serious projects are able to reserve capacity.

Our preferred solution is as we set out in the February seminar. Initially, we believe that a new entrant should be exposed to a fixed £/kW liability. We initially suggested £1/kW as an appropriate level. In light of subsequent debate, it may be that a level higher than this is more appropriate. It may even be that a graduated rate which increases as the size of the project reduces is necessary in order to ensure that the incentive is maintained. For instance, at £1/kW a 1000MW project would incur a £1m liability, whereas a 50MW project would incur only £50k. It may therefore be more appropriate to use a higher rate for smaller projects, or perhaps require all projects to pay the higher of £Xs or £Y/kW. However, we do not believe that setting this to a level as high as a number of years' TNUoS liability would help and is likely to make this issue worse.

After consents have been granted to the project, we believe that the generator's liability should follow a more conventional 'S curve' profile. This would be calculated by taking the estimated profile of costs for the infrastructure works required for the cluster as a whole and allocating a share in proportion to the generator's share of the total generation capacity of the cluster. This profile would be calculated when the offer is made, would be written into the construction agreement for the site and could not be changed unless both National Grid and the relevant generator agree.

There are a number of consents which have a bearing on the risk of the project. We had originally considered whether a wider definition of consents should be used as a trigger point. However, we are also mindful that the relevant measure must be highly transparent and not open to delaying tactics. Therefore, we believe that Section 36 consent should be used as a trigger for those stations large enough to require it, whereas smaller stations could use the granting of Local Planning Authority consent. There may be situations where such consent is granted with a number of conditions attached. In those circumstances it is sensible that National Grid takes a view as to whether consent should be deemed to be granted for these purposes. This could perhaps be undertaken with reference to Ofgem as final arbiter. We consider that on balance this is the best choice of trigger and would certainly represent a significant improvement on the present arrangements.

We also believe that this level should act a cap on the generator's liability. If actual spend outturns below the profile then only this level should be recoverable from the generator. Whilst this may appear to be somewhat of a one way bet, there is an asymmetry between the generator and National Grid with respect to information on costs and the ability to influence the level of spend. Therefore, it is appropriate that this is reflected in the nature of the risk sharing arrangements.

We have put these views to National Grid in response to their consultation on managing access to the GB transmission system. We welcome their commitment to address this issue and we would urge Ofgem to provide any necessary regulatory consent and guidance in order that it can be achieved speedily.

Other issues

The present queue of applications was created as a result of the decision, during the introduction of BETTA, to set a deadline before which new connections would be assessed ignoring the full effects on the GB transmission system. Consequently, a number of prospective schemes brought their applications forward in order to be judged under these less robust requirements. The queue contains a variety of schemes at different stages in the planning process and with differing likelihoods of commissioning. The present arrangements provide for connection applications to be accommodated on a first come first served basis.

There are some schemes which have received planning consents but have received offers for connection with dates later than other schemes which are less advanced in the planning process. This situation would at first glance appear to discriminate against those schemes in possession of consents. However, all potential applicants knew that applications would be assessed on a first come first served principle when the deadline was set. Therefore, it could be argued that to change the rules significantly at this stage would be unfair to other applicants who worked hard to bring their applications forward and who may not be too far off receiving consents for their own schemes anyway.

Additionally, it is almost certain that the connection dates for schemes will be brought

forward as other parties in the queue fail to sign offers or terminate their construction agreements, particularly to avoid final sums liabilities on uncertain projects. Therefore, it is not clear as yet that the first come first served principle has failed and we would recommend waiting further before deciding that it has to be changed. If there is deemed to be an issue, it is possible that a balanced scorecard approach as proposed by National Grid would be an appropriate response, although this would have to be designed carefully so as to avoid unduly discriminating against some parties.

Another similar issue exists. At present, it is difficult for the transmission companies to ascertain exactly how much reinforcement is likely to be required on the system to accommodate the GB queue, or where it will be required. Whilst we accept that this is a valid issue, it is not clear that any of the alternatives would provide a better signal.

There are two elements of information which the transmission companies require. Firstly, they need to know which of the generation projects in the queue will proceed to commissioning. Secondly, it is necessary to know when existing generators will decommission. It has been suggested that requiring all generators to commit to a number of years' TNUoS payments would provide a more certain signal of intent. In the case of a new connection it may provide a keener incentive on new generators to only request a connection when they are certain of proceeding further. However, this will serve to decelerate the rate of new build, which is likely to have a detrimental effect on security of supply.

In respect of existing generators, there are a number of effects that such a TNUoS commitment could have. In areas where 5 years' worth of TNUoS is not a significant amount, due to low or even negative TNUoS charges, then existing plant will simply commit to the charges and close whenever it suits them anyway.

Where charges are more significant there are two ways plant could be affected. In some circumstances the commitment will have been incurred and will therefore be regarded as a sunk cost. Therefore, the potential avoided TNUoS costs will be taken out of the decommissioning decision in the medium term which may extend the decommissioning date. This could result in infrastructure being required for a short period only, to accommodate both new entrants and the existing generator which would not have been required had it decommissioned earlier. Another response might be that a station decommissions earlier than it would have when faced with the requirement to commit to a future 5 years' TNUoS (for example, it may have anticipated running for 2 or 3 years). This effect would occur when the new arrangements are implemented, which is when the commitment would first be required. Bringing forward the closure of generation capacity in this way could detrimentally affect security of supply.

Therefore, there are a number of different effects which could arise from such a proposal. In one case only the information is improved and this results in the bringing forward of the closure decision which could have a detrimental effect for security of supply.

We also do not agree with proposals to require the Transmission Owners to provide firm access rights once the "local" works have been finished. The GB queue exists purely

because it will take a number of years to accommodate the present volume of connection applicants. To pretend that constraints do not exist and to offer access rights anyway will further increase the costs of balancing over and above those which have already been experienced since the implementation of BETTA. Indeed as much of the new generation will be renewable, the compensation will be higher than that required for conventional generators as the cost of lost ROC revenue will be factored in. This lost renewable generation will attract the buy out price, so in effect customers will pay twice for renewable generation which has not even been provided.

It is this risk of totally unacceptable, and indeed unnecessary, levels of balancing costs which has driven our strong opposition to proposals such as the BWEA's "connect and manage" approach. Although we are members of the BWEA, we have a wider interest in the market and believe that such an additional burden on customers would be wholly unacceptable.

In conclusion therefore, we believe that although the present system is indeed creating a barrier to entry into the generation market, our proposed changes to the Final Sums Liability provisions are sufficient to improve the situation. We believe that these changes can be made quickly and then should be formalised at a later date in the CUSC. It is too early to tell whether or not the first come first served principle has failed. If on further examination it is deemed to have failed, then a balanced score card approach may be able to ensure that schemes are reprioritised accordingly. We do not believe that more fundamental reform is necessary and indeed could be detrimental to efficiency and competition.

Yours sincerely,

Paul Jones
Trading Arrangements