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Dear Dena,

Locational BSUoS Charging Methodology – GB ECM-18 Regulatory Impact Assessment

Thank you for the opportunity to respond to the above Regulatory Impact Assessment. E.ON UK is supportive of the aims of GB ECM-18 in that it seeks to target the cost associated with derogated boundaries more appropriately. However, we have some concerns with the detail of what is presently being proposed; in particular the proposed discount in TNUoS for zones behind a derogated boundary. Clearly there is also a question on the interaction of this amendment with the announcement last week from DECC that the Secretary of State is presently minded to put in place an enduring Connect and Manage access regime with socialised balancing costs.

As we have stated in previous responses to DECC's consultation on Transmission Access reform, we believe that Connect and Manage should not be seen as a replacement for investment in the wider system to the appropriate standard as set out in the SQSS. We believe that strategic investment proposals currently being progressed by Ofgem and the industry are very important. It is crucial that network companies are incentivised to carry out reinforcement work in a timely manner to ensure that generation located in Scotland competes on a level basis with generation elsewhere in GB, as well as in the wider European context as the amount of interconnections increases. Connect and Manage should simply facilitate the transitional period between connecting generators and completing the necessary reinforcements on the system. Therefore, locational BSUoS charges should be similarly transitory in their application.

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The principle of a targeted charge

Historically, discussion of the issue of balancing costs caused by derogated boundaries has been focussed on the B6 or Cheviot boundary, as this is currently the only derogated boundary in existence. Clearly, in the longer term as interim Connect and Manage arrangements bring on more generation capacity ahead of system reinforcements and as similar enduring arrangements are put in place, more boundaries are likely to become derogated for a period of time. It is therefore important that costs associated with managing the constraints on these boundaries are kept under control.

We believe that the principle behind a targeted charge is appropriate and consistent with the approach adopted for local design variations under the Security and Quality of Supply Standards (SQSS), where any balancing costs caused as a result are not socialised through BSUoS and are targeted back at the generator itself. The derogated boundary is a similar situation, but potentially affects a wider number of parties and occurs deeper into the network. Therefore, the Targeted Constraint Charge (TCC) is logically consistent as it avoids the costs being smeared across all parties but is targeted as this wider number of parties rather than at a specific generator.

A targeted charge in the form proposed under GB ECM-18 has the ability to influence the level of costs in two ways. Firstly, it will provide an incentive for generators to avoid running in constrained periods. This is a volume effect which reduces the incidence of constraints. However, secondly there will be a price effect as parties that price bids at levels that drive up balancing costs will have the costs targeted back at them to a large extent which should directly influence their bidding behaviour.

Of course, in order to influence behaviour, parties should be in a position to respond to the price signals being sent. This is more difficult with a charge which is calculated ex post in the manner proposed for the TCC. That is not to say that ex post charges cannot provide such a signal. For instance, Imbalance Prices and BSUoS are currently calculated on an ex post basis, so there is a precedent to some extent. However, in order for generators to be able to manage their position in relation to the TCC they will require information to allow them to predict when the charge is likely to be applied.

The first thing that needs to be clear is the exact location of the derogated boundary, as generators need to know whether or not there is a possibility of the charge applying at all. This is a relatively straight forward exercise in respect of the current derogated B6 boundary. However, in future other boundaries may be less easy to define. Nevertheless, a clear definition is necessary.

Secondly, generators will need to know when the constraint is likely to apply. Of course this is in part affected by the running decisions of the generators behind the derogated boundary which won't be known with certainty until close to real time and would therefore limit the ability of National Grid to forecast it accurately. However, the ex ante forecast information that National Grid is proposing to make available should be helpful allowing generators at least to ascertain which periods are most likely to incur locational BSUoS charges.

The proposed TNUoS discount

The argument made for a reduced TNUoS charge is that it is consistent with the calculation of the TCC. TCC is calculated on the basis that the network is not compliant, charging the costs incurred on the derogated boundary over and above those which would have existed under a compliant system. It is therefore argued that it is incorrect that the TNUoS model should assume a compliant system. However, we do not believe that the transport model does indeed assume a compliant system. It simply assumes the system is configured as at present and does not second guess how the system design would evolve with the addition or removal of generation or demand at different locations.

The model calculates changes in flows associated with the addition of 1MW of generation at different locations and signals the marginal investment that is caused. The assumption in the model is that the additional capacity can be provided in small amounts (ie the network could accommodate the additional 1MW by building just enough additional capacity on the present network for that 1MW alone and no more or no less). It also ignores the reality of the actual usage of the current system which may be derogated, fully utilised or with spare capacity.

If the generation is to be scaled back in circumstances where insufficient transmission system has been installed in reality, then logically it should be scaled up when too much is installed. Presumably at this point the system is “over compliant” as generators are not automatically entitled to a system which is built to higher standards than prescribed in the SQSS. Of course, this doesn’t happen in the model at present and neither do we believe that it should. However, it illustrates that the logic behind the discount is fundamentally flawed and inconsistent with the approach adopted with the model to date. Indeed, it is not clear what the discount provides other than perhaps a means to soften the effects of moving to a locational BSUoS regime.

What is clear is that the locational BSUoS charge will be calculated on the basis of one level of generation behind the derogated boundary whilst the locational TNUoS charge will be calculated assuming a significantly smaller amount. Therefore inconsistent assumptions are being made which is likely to lead to inconsistent charges.

The interaction with the enduring TAR regime

The recent statement from DECC on TAR as to the Secretary of State’s chosen model to take forward for consultation means that there is an implementation issue to consider with respect to GB ECM-18. On one hand the preferred model of Connect and Manage with socialised costs has yet to be consulted upon, so it would be premature to assume that this will be the model that is finally put in place, even if there is a high probability that this will indeed be the case. On the other hand it would appear inefficient to put in place a charging change which seems on the face of it to have a limited life.

Previously, Ofgem has put on hold decisions on CUSC amendments which relate to the Transmission Access Review so as not to prejudge the outcome of DECC’s consultation. However, of course with charging changes Ofgem is required to make a decision by a specific date which does not leave this option open to it. Ofgem presumably also has to

make the decision on the basis of the regime that is currently in place at the time. Therefore, the Authority may feel that it is required to implement GB ECM-18, even if potentially only for a short period of time, as it would better meet National Grid's charging objectives compared with the current baseline.

We assume that discussions will take place between DECC and Ofgem as to how best to progress this issue.

I hope that the above comments prove helpful.

Yours sincerely

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Trading Arrangements