

Ian Marlee  
Partner, GB Markets  
Ofgem  
9 Millbank  
London  
SW1P 3GE

8 July 2011

Dear Ian,

### **National Grid Electricity Transmission System Operator Incentives from 1 April 2011**

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. We provide 50% of the UK's low carbon generation. Our interests include nuclear, coal and gas-fired electricity generation, renewables, combined heat and power plants, and energy supply to end users. We have over 5 million electricity and gas customer accounts in the UK, including both residential and business users.

EDF Energy welcomes the opportunity to respond to this consultation. The key points of our response are as follows:

- We welcome the revised approach to incentives and the proposal to implement a two year incentive scheme.
- This new approach places significant reliance on the robustness and accuracy of modelling techniques, and so we welcome the scrutiny that Ofgem and its consultants have applied to ensure that the modelling is as accurate as is reasonably practicable.
- We agree that the scheme design and governance arrangements are reasonable, although we make a suggestion in our response regarding audit or witnessing of the model runs.
- We would welcome more frequent and detailed publication of Balancing Services Use of System (BSUoS) charges and believe that this new methodology allows for more accurate forecasts.

We have previously stated our support for longer term incentives schemes. We believe that such schemes allow National Grid Electricity Transmission (NGET) to take a view of costs and benefits over longer timescales, which should result in more efficient processes and investments than a shorter one year scheme. We therefore welcome the proposed scheme for 2011-2013 in this Final Proposals consultation. The revised approach should, in our view, allow incentives to be maintained on the System Operator (SO) throughout the duration of the scheme. It reflects normal business practice to ensure that there is an incentive to manage costs throughout the scheme.

The new approach places significant reliance on the accuracy of modelling techniques. We note the publication of methodology statements from NGET, which are beneficial in providing an understanding of the incentive scheme methodology and approach to

modelling. We particularly welcome the report from Frontier Economics on the energy and constraints models. We continue to believe that transparent information will reduce the uncertainty for system users in establishing their system costs, and this increased predictability will benefit the end consumer. We would therefore welcome any further publication or sharing of information from NGET in respect of the models they use.

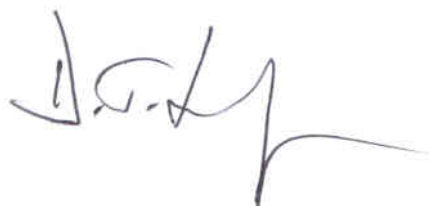
Overall, we agree with the scheme design and acknowledge that the proposed +/- £50m profit cap and loss floor on NGET does provide a stronger incentive to reduce costs.

Finally, we hope that this new methodology will allow for greater transparency and publication of more detailed reports in respect of BSUoS forecasts, which has the potential to provide benefits to the end consumer. Ensuring that industry is kept up to date on a more frequent basis in this respect, e.g. monthly, will be a notable improvement on previous reporting intervals.

Our detailed responses are set out in the attachment to this letter.

Should you wish to discuss any of the issues raised in our response or have any queries, please contact my colleague Rob Rome on 01452 653170, or myself.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'D. Linford', with a long horizontal flourish extending to the right.

**Denis Linford**  
**Corporate Policy and Regulation Director**

## Attachment

### National Grid Electricity Transmission System Operator Incentives from 1 April 2011

#### EDF Energy's response to your questions

##### CHAPTER 2 – Incentive methodology

###### **Question 2: Do you consider that the final proposals' proposed incentive methodology for the SO incentive scheme is reasonable?**

Yes, we welcome this longer term scheme and the focus on ensuring that items within the SO's control can be appropriately incentivised throughout the duration of the scheme. We agree that the proposed methodology is a reasonable approach to ensuring the appropriate inputs are identified as ex-ante or ex-post. We welcome the ongoing focus from Ofgem with the aim that NGET continue to improve forecasting and planning capabilities.

###### **Question 3: Do you consider that the proposed licence modifications appropriately reflect the final proposals as described in this chapter?**

Yes, our interpretation of the proposed licence modifications is that they reflect the final proposals.

##### CHAPTER 3 – Modelling: energy and constraint costs

###### **Question 4: Do you consider that the approach to modelling energy and constraints costs as detailed in the final proposals are reasonable?**

We welcome the revised approach to modelling, which has reduced the notable reliance on historic data, and agree that the final proposals appear reasonable. However, we feel it would be beneficial to provide more transparent information regarding some of the key assumptions used by NGET such as RPI.

We note the relationship between NGET constraint management through contracts which influence Balancing Mechanism (BM) prices and the treatment of BM prices as ex post for the purposes of the constraint cost modelling. We agree that Ofgem's decision to introduce a temporary restriction on any such contracts is warranted to ensure the incentive works as is intended.

It would be good practice for NGET's modelling to be audited or independently witnessed, by Ofgem or by another party, either at the time of the runs or later on a spot check re-run basis. This would provide confidence to the industry.

In our most recent response to NGET we requested greater justification of the discount factor to be applied to the BM prices and welcome the analysis Ofgem has received from

their independent consultant. The use of 41%, higher than the figure proposed by both NGET and the consultants, will ensure that NGET receive benefits only where they have improved their performance.

**Question 5: Do you consider that the proposed licence modifications appropriately reflect the final proposals as described in this chapter?**

Yes, our interpretation of the proposed licence modifications is that they reflect the final proposals.

**CHAPTER 4 – Scheme design and governance**

**Question 6: Do you consider that the final proposals' proposed scheme design and governance arrangements for the SO incentive scheme to apply to NGET's external SO costs are reasonable?**

Yes, we support a longer term scheme as we agree that there are a number of benefits such as allowing NGET to consider investments in processes, procedures and resources which will enhance their role of system operation where the costs will pay back over a longer period of time. We support the use of a symmetrical cap and floor in the scheme design and acknowledge that the proposed +/- £50m does provide a stronger incentive. We also welcome the response from NGET identifying that the two year scheme design has increased transparency and a reduced volatility giving a reduced scope for windfall gains and losses which provides some justification for the level of the cap/floor.

**Question 7: Do you consider that the proposed licence modifications appropriately reflect the final proposals as described in this chapter?**

Yes, our interpretation of the proposed licence modifications is that they reflect the final proposals.

**CHAPTER 5 – Transmission losses and black start**

**Question 8: Do you consider that the final proposals' approach to transmission losses and black start for the SO incentive scheme to apply to NGET's external SO costs are reasonable?**

We agree that the proposals appear reasonable and welcome the specific licence condition to allow NGET to manage the uncertainty around the provision of black start from new providers. We agree that it would not be appropriate to provide an allowance for this work at this time.

**Question 9: Do you consider that the proposed licence modifications appropriately reflect the final proposals as described in this chapter?**

Yes, our interpretation of the proposed licence modifications is that they reflect the final proposals.

## **CHAPTER 7 – Summing up**

**Question 10: Do you consider that the final proposals for the SO incentive scheme to apply to NGET's external SO costs represent a fair balance of risk and reward?**

We agree that the final proposals appear reasonable.

**Question 11: Do you consider that the proposed licence modifications appropriately reflect the final proposals as described in this chapter?**

Yes, our interpretation of the proposed licence modifications is that they reflect the final proposals.

**EDF Energy  
July 2011**