



E.ON UK plc
Westwood Way
Westwood Business Park
Coventry
West Midlands
CV4 8LG
eon-uk.com

Giuseppina Squicciarini
Ofgem
9 Millbank
London
SW1P 3GE

Richard Fairholme
Trading Arrangements
T: +44 (0)2476 181421
richard.fairholme@eon-uk.com

26 July 2011

Dear Giuseppina,

RE: System Operator incentive schemes from 2013

E.ON UK welcomes the opportunity to provide comments on the gas and electricity System Operator Incentives arrangements post-2013. Due to the different structure and nature of incentive arrangements between gas and electricity, we have dealt with each separately, below.

Electricity System Operator Scheme

The incentive scheme set for the National Electricity Transmission System Operator (NETSO) for the period 2011/13 saw a large departure from previous years. Firstly, the scheme was set for a two year period rather than the normal one year. Secondly, there was a major change in how the scheme parameters were set, with the introduction of a target which was set not as an actual number, but as a series of relationships to perceived drivers of costs. This is a lot of change for transmission Users to absorb and adapt to.

There appears to be a perception that the industry is best placed to monitor National Grid's performance as NETSO and judge whether the costs it has incurred are reasonable. Whilst industry participants in their dealings with National Grid may come across particular situations where they are unsure as to why a particular course of action has been taken by the NETSO, the industry is limited to the extent that it can monitor and assess the NETSO's overall performance.

E.ON UK plc
Registered in
England and Wales
No 2366970
Registered Office:
Westwood Way
Westwood Business Park
Coventry CV4 8LG

A central team at Ofgem, with its powers to request the information it needs from the transmission companies, will always, in our opinion, be in a better position to perform this function. Even so, there will still be an asymmetry between the information held by the NETSO and Ofgem, as there is indeed between the NETSO and the industry.

In our opinion, complexity in the scheme parameters increases the asymmetry in the relative positions of parties to monitor and understand the performance of the NETSO. Therefore, we would advise against the introduction of further significant change or complexity. As we mention above, we currently have a scheme which is dependent on relationships which have been defined between perceived cost drivers and various elements of the scheme's incentivised costs. The strength of these relationships against past data differs. Some show strong correlations whilst other relationships are less convincing. However, at a point which is only three months into a 24 month scheme, no one is in a position to tell whether this new structure is robust for future years.

In our opinion, it is not appropriate to be planning significant changes to the structure of the scheme at this moment in time. Changes for the next scheme may be required, not least if significant concerns arise in relation to the new format scheme introduced this time around. However, what industry participants, National Grid and Ofgem need at present is a period of time to get used to the present arrangements and to reflect on how successful they have been. Once this has been achieved then it may be appropriate to embark on the next big initiative.

Gas System Operator Scheme

We have strong concerns about incentives which could potentially last up to eight years (i.e. to match the length of the next price control). Whilst this approach is designed to encourage longer-term focus by the SO, it comes at the significant risk of exposing Shippers and consumers to unnecessary costs, particularly if the incentives are not delivering the expected outcomes. We would not want to be locked into such an arrangement for up to eight years. Longer term incentives also expose the industry to the risk of unintended consequences and unpredictable Income Adjusting Events.

We believe there may be a case for greater bundling of the incentives in gas to avoid NGG focusing on specific areas of system operation which provide the most financial gain from the incentive arrangements. Whilst Ofgem has identified some interesting areas of overlap between the existing incentives, we believe the potential impact needs to be explored and analysed in more detail, rather than just expressed as a concept. The same applies to Ofgem's possible "*volume/cost minimisation incentive scheme*", which given the significant shift from the current arrangements, requires more detailed explanation and industry debate.

Our more detailed comments on the gas SO Incentive issues of most interest to us are detailed below.

Demand Forecasting

We believe the 13:00 D-1 forecast remains the most important (and relied upon) demand forecast provided by NGG. Although some shippers are capable of producing their own forecasts, many also rely on National Grid's information and therefore it is important that it is as accurate as possible, all year round. As we have noted in previous SO incentive responses, NGG should be assisting its customers in providing more accurate inputs or considering ways in which DN forecast accuracy (which is not incentivised) could be improved, in order to mitigate the industry risk associated with inaccurate demand forecasting.

Maintenance

Our position on NTS maintenance remains that National Grid should be encouraged to be flexible in its approach to planning and implementing its maintenance programmes. We would, therefore, strongly support Ofgem's proposal for a maintenance-related incentive and/or obligations. However, we are unsure what Ofgem's initial proposal to "*incentivise NGG to take into account the costs incurred by shippers pursuant to the maintenance schedule*" actually means in practice. Shippers are unlikely to want to share confidential commercial costs with NGG and even if they did, Shippers would be sceptical about what purpose NGG would then use this information for.

NGG sticking to agreed maintenance plans is particularly important for routine operations, such as meter inspections. Whilst the cost of doing such maintenance for NGG is likely very low, if the meter being inspected requires a power station to shut down or change its availability, the cost can be huge. If there is a last minute change to the meter inspection – e.g. moved to the day after at short notice, then the costs can be very extensive, since the power station would then be faced with an unexpected outage and significant commercial risks to manage.

Such risks can be mitigated by more effective communication between NGG and customer. As we have noted previously, Terminal Operators are currently expected to provide NGG with availability and planned maintenance period three or four times per year. We suggested that this practice could be transferred to offtakes, as well. This would result in a more active review process throughout the year for both Shippers and NGG, ensuring that both parties have the most recent information available to them and enabling any problems to be ironed out at an earlier stage. An "incentive" to minimise the duration of a customer's outage for



maintenance purposes may merit further consideration, provided this did not then lead to more rigidity in the overall process.

Above all, what we are trying to achieve in maintenance scheduling and planning is greater flexibility from NGG. This is important because, as we have noted previously, different types of offtakes have different operating requirements, which make the moving of maintenance dates more (or less) likely. For instance, CCGT maintenance is predominately governed by running hours not time intervals so there is a strong likelihood that initial dates provided in October planning will subsequently change as a result of changes to the operation of the plant.

Introducing a more customer-focused process including more regular consultation and bilateral discussions is likely to address many Shippers' concerns in this area. We are open-minded; therefore, whether an incentive is necessarily the appropriate solution, but feel that this issue requires Ofgem's further attention.

Data Publication

With the introduction of National Grid's "MIPI" system, which was designed to facilitate easier access to market data, we note that increasingly more Shippers now use National Grid's website to obtain such data to feed into their own IT systems. This is a change from previous years, when the "Gemini" system was used as the primary source. It is therefore very important that National Grid has an obligation specifically on website availability. As stated previously we do not believe this area merits an incentive and could be achieved either through a licence or standard of service obligation to maintain a very high level of availability.

I hope that the above comments prove useful. Should you wish to discuss our response in any further detail, please do not hesitate to contact me on the number above.

Yours sincerely,

Richard Fairholme (by email)

Trading Arrangements

E.ON UK